ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 31, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc
(Exact name of Registrant as specified in its charter)

United Kingdom
(Jurisdiction of incorporation or organization)

RBS Gogarburn, PO Box 1000, Edinburgh EH12 1HQ, United Kingdom
(Address of principal executive offices)

Aileen Taylor, Group Secretary, Tel: +44 (0) 131 626 4099, Fax: +44 (0) 131 626 3081

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 20 ordinary shares, nominal value £0.25 per share	New York Stock Exchange
Ordinary shares, nominal value £0.25 per share	New York Stock Exchange*
American Depositary Shares Series F, H, L, M, N, P, Q, R, S, T and U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, M, N, P, Q, R, S, T and U respectively	New York Stock Exchange
Dollar Perpetual Regulatory tier one securities, Series 1	New York Stock Exchange
Senior Floating Rate Notes due 2013	New York Stock Exchange
3.400% Senior Notes due 2013	New York Stock Exchange
3.250% Senior Notes due 2014	New York Stock Exchange
3.950% Senior Notes due 2015	New York Stock Exchange
4.875% Senior Notes due 2015	New York Stock Exchange
4.375% Senior Notes due 2016	New York Stock Exchange
5.625% Senior Notes due 2020	New York Stock Exchange
6.125% Senior Notes due 2021	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2010, the close of the period covered by the annual report:

Ordinary shares of 25 pence each	58,458,130,868	Non-cumulative dollar preference shares, Series F, H and L to U	209,609,154
B Shares	51,000,000,000	Non-cumulative convertible dollar preference shares, Series 1	64,772
Dividend Access Share	1	Non-cumulative euro preference shares, Series 1 to 3	2,044,418
11% cumulative preference shares	500,000	Non-cumulative convertible sterling preference shares, Series 1	14,866
5½% cumulative preference shares	400,000	Non-cumulative sterling preference shares, Series 1	54,442

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes o No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

o Yes x No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

o Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-Accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

o U.S. GAAP
x International Financial Reporting Standards as issued by the International Accounting Standards Board
o Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

o Item 17 o Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

SEC Form 20-F cross reference guide

Contents

In this document, and unless specified otherwise, the term ‘company’ or ‘RBSG’ means The Royal Bank of Scotland Group plc, ‘RBS’, ‘RBS Group’ or the ‘Group’ means the company and its subsidiaries, ‘the Royal Bank’ means The Royal Bank of Scotland plc and ‘NatWest’ means National Westminster Bank Plc.

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

Certain information in this report is presented separately for domestic and foreign activities. Domestic activities primarily consist of the UK domestic transactions of the Group. Foreign activities comprise the Group's transactions conducted through those offices in the UK specifically organised to service international banking transactions and transactions conducted through offices outside the UK.

The geographic analysis in the Business Review, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have been compiled on the basis of location of office - UK and overseas. Management believes that this presentation provides more useful information on the Group's yields, spreads and margins of the Group's activities than would be provided by presentation on the basis of the domestic and foreign activities analysis used elsewhere in this report as it more closely reflects the basis on which the Group is managed. ‘UK’ in this context includes domestic transactions and transactions conducted through the offices in the UK which service international banking transactions.

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 2006 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together ‘IFRS’) as adopted by the European Union. They also comply with IFRS as issued by the IASB.

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

RFS Holdings B.V. has now substantially completed the separation of the business units of ABN AMRO Holding N.V.. As part of this reorganisation, on 6 February 2010, the businesses of ABN AMRO Holding N.V. acquired by the Dutch State were legally demerged from those acquired by the Group and were transferred into a newly established company, ABN AMRO Bank N.V. (save for certain assets and liabilities acquired by the Dutch State that were not part of the legal separation and which will be transferred to the Dutch State as soon as possible).

Legal separation of ABN AMRO Bank N.V. occurred on 1 April 2010, with the shares in that entity being transferred by ABN AMRO Holding N.V (renamed RBS Holdings N.V. at legal separation) to a holding company called ABN AMRO Group N.V., which is owned by the Dutch State.

Following legal separation, RBS Holdings N.V. has one direct subsidiary, The Royal Bank of Scotland N.V. (RBS N.V.), a fully operational bank within the Group. RBS N.V. is independently rated and regulated by the Dutch Central Bank. Certain assets within RBS N.V. continue to be shared by the Consortium Members.

Statutory results
The statutory results of the Group include the results and financial position of RFS Holdings, the entity that acquired ABN AMRO (see page 2). The interests of the State of the Netherlands and Santander are included in non-controlling interests.

Glossary
A glossary of terms is detailed on pages 390 to 395.

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’, ‘intend’, ‘plan’, ‘could’, ‘probability’, ‘risk’, ‘Value-at-Risk (VaR)’, ‘target’, ‘goal’, ‘objectiv ‘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 restructuring plans, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets, return on equity (ROE), cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; the Group’s future financial performance; the level and extent of future impairments and write-downs; the protection provided by the Asset Protection Scheme (APS); and 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. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. 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 full nationalisation of the Group or other resolution procedures under the Banking Act 2009; the global economy and instability in the global financial markets, and their impact on the financial industry in general and on the Group in particular; the financial stability of other financial institutions, and the Group’s counterparties and borrowers; the ability to complete restructurings on a timely basis, or at all, including the disposal of certain Non-Core assets and assets and businesses required as part of the EC State Aid restructuring plan; organisational restructuring; the ability to access sufficient funding to meet liquidity needs; the extent of future write-downs and impairment charges caused by depressed asset valuations; the inability to hedge certain risks economically; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the United States; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; ineffective management of capital or changes to capital adequacy or liquidity requirements; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; HM Treasury exercising influence over the operations of the Group; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group’s operations) in the United Kingdom, the United States and other countries in which the Group operates or a change in United Kingdom Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G7 central banks; impairments of goodwill; pension fund shortfalls; litigation and regulatory investigations; general operational risks; insurance claims; reputational risk; general geopolitical and economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the ability to achieve revenue benefits and cost savings from the integration of certain of RBS Holdings N.V.’s (formerly ABN AMRO Holding N.V.) businesses and assets; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; the participation of the Group in the APS and the effect of the APS on the Group’s financial and capital position; the ability to access the contingent capital arrangements with HM Treasury; the conversion of the B shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group’s activities as a result of HM Treasury’s investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as of the date of this announcement, 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.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicitation of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.

4

 Business review

Description of business

Introduction

The Royal Bank of Scotland Group plc is the holding company of a large global banking and financial services group. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its two principal subsidiaries, the Royal Bank and NatWest. Both the Royal Bank and NatWest are major UK clearing banks whose origins go back over 275 years. In the United States, the Group's subsidiary Citizens is a large commercial banking organisation. Globally, the Group has a diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers in over 50 countries.

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

During the year, the company converted non-cumulative convertible preference shares into ordinary shares in the company. As a result, HM Treasury’s holding in the company’s ordinary shares reduced to 67.8% and its economic interest reduced to 82.8%.

The Group had total assets of £1,453.6 billion and owners' equity of £75.1 billion at 31 December 2010. The Group's capital ratios, were a Total capital ratio of 14.0 per cent, a Core Tier 1 capital ratio of 10.7 per cent and a Tier 1 capital ratio of 12.9 per cent, at 31 December 2010.

Organisational structure and business overview

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

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through the RBS and NatWest networks of branches and ATMs in the United Kingdom, and also through telephone and internet channels. UK Retail launched the Retail Customer Charter in June 2010 and progress against the commitments made will be formally reported every six months.

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

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

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

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

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

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

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

RBS Insurance provides a wide range of general insurance products to consumers through a number of well known brands including; Direct Line, Churchill and Privilege. It also provides insurance services for third party brands through its UKI Partnerships division. In the commercial sector, its NIG and Direct Line for Business operations provide insurance products for businesses via brokers or direct respectively. Through its international division, RBS Insurance sells general insurance, mainly motor, in Germany and Italy. In addition to insurance services, RBS Insurance continues to provide support and reassurance to millions of UK motorists through its Green Flag breakdown recovery service and Tracker stolen vehicle recovery and telematics business.

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

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

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

Business divestments
To comply with EC State Aid requirements the Group has agreed a series of restructuring measures to be implemented over a four year period from December 2009. This will supplement the measures in the strategic plan previously announced by the Group. These include divesting RBS Insurance, 80.01% of Global Merchant Services and substantially all of RBS Sempra Commodities JV business, as well as divesting the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the Direct SME customers across the UK.

Recent developments
Gender equality in insurance contracts
On 1 March 2011, the European Court of Justice (ECJ) upheld a ruling that insurers are no longer allowed to use gender as a rating factor across the Insurance industry. This will have a significant impact on the insurance industry in calculating premiums and determining benefits. The Group is currently working through the findings, and any consequences arising will be rectified by December 2012 in line with the ruling from the ECJ. At this stage, it is not possible to estimate the impact which the ECJ's ruling may have on the Group's businesses, financial position or profitability.

Budget update
On 23 March 2011, the UK Government announced plans to reduce the main rate of corporation tax by a further 1%. From April 2011, the rate will be reduced from 28% to 26% and, by 2014, it will reach 23%. Also announced, was an increase in the rate of the Bank Levy to 0.078% from January 2012.

Personal current accounts
On 29 March 2011, the OFT published its update report in relation to personal current accounts. This noted further progress in improving consumer control over the use of unarranged overdrafts. In particular, the Lending Standards Board has led on producing standards and guidance to be included in a revised Lending Code published on 31 March 2011. The OFT will continue to monitor the market and will consider the need for, and appropriate timing of, further update reports in light of other developments, in particular the work of the Independent Commission on Banking. The OFT intends to conduct a more comprehensive review of the market in 2012.

US dollar clearing activities
On 31 March 2011, the U.S. Department of Justice and RBS N.V. filed a joint status report with the U.S. District Court notifying it that the parties would seek an extension of the duration of RBS N.V.'s deferred prosecution agreement until 31 December 2011. The request states that RBS N.V. and the Department of Justice have agreed to

seek the extension to allow RBS N.V. sufficient time to fulfil its obligations under the agreement.

Competition

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

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities.

In asset finance, the Group competes with banks and 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 clearing banks and building societies, major retailers and life assurance companies. In the mortgage market, the Group competes with UK clearing banks and building societies. The ambitions of non-traditional players in the UK market remain strong with retailers and new entrants forming aggressive expansion plans. The Group's life assurance businesses compete with Independent Financial Advisers and life assurance companies.

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 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.

RBS Insurance competes in personal lines insurance and, to a more limited extent, in commercial insurance. There is strong competition from a range of insurance companies which now operate telephone and internet direct sales businesses. Competition in the UK motor market remains intense, and price comparison internet sites now play a major role in the marketplace. These sites are now extending their scope to home insurance and other lines. RBS Insurance also competes with local insurance companies in the direct motor insurance markets in Italy and Germany.

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

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

Risk factors

Set out below is a summary of certain risks which could adversely affect the Group. These should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 352 to 369.

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

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

- The Group's businesses, earnings and financial condition have been and will continue to be affected by geopolitical conditions, the global economy, the instability in the global financial markets and increased competition. These have resulted in significant changes in market conditions including interest rates, foreign exchange rates, credit spreads, and other market factors and consequent changes in asset valuations.

- The Group requires access to sources of liquidity, which have been constrained in recent years, and a failure to access liquidity due to market conditions or otherwise could adversely affect the Group's financial condition. In addition, the Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings.

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

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

- The Group's insurance businesses are subject to inherent risks involving claims on insured events.

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

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

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

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

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

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

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

- The Group's participation in the APS is costly and complex and may not produce the benefits expected and the occurrence of associated risks may have a material adverse impact on the Group's business, capital or tax position, financial condition and results of operations. Any changes to the regulatory treatment of the APS may negatively impact the Group's capital position and any withdrawal from, or termination of, the APS will be costly.

Key financials

for the year ended 31 December	2010 £m	2009 £m	2008 £m
Total income	31,868	33,026	20,730
Operating loss before tax	(399)	(2,647)	(25,691)
Loss attributable to ordinary and B shareholders	(1,125)	(3,607)	(24,306)
Cost:income ratio	57%	53%	169%
Basic loss per ordinary and B share from continuing operations (pence)	(0.5p)	(6.3p)	(146.2p)

at 31 December	2010 £m	2009 £m	2008 £m
Total assets	1,453,576	1,696,486	2,401,652
Funded balance sheet (1)	1,026,499	1,255,032	1,409,093
Loans and advances to customers	555,260	728,393	874,722
Deposits	609,483	756,346	897,556
Owners' equity	75,132	77,736	58,879
Risk asset ratio			
- Core Tier 1	10.7%	11.0%	6.6%
- Tier 1	12.9%	14.1%	10.0%
- Total	14.0%	16.1%	14.1%

Note:

(1) Funded balance sheet represents total assets less derivatives.

Overview of results

The results of RFS Holdings B.V., the entity that acquired ABN AMRO, are fully consolidated in the Group’s financial statements. The interests of the State of the Netherlands and Santander in RFS Holdings are included in non-controlling interests. Legal separation of ABN AMRO Bank N.V. took place on 1 April 2010.

Summary consolidated income statement

	2010 £m	2009 £m	2008 £m
Net interest income	14,209	13,388	15,482
Fees and commissions receivable	8,193	8,738	8,855
Fees and commissions payable	(2,211)	(2,790)	(2,444)
Other non-interest income	6,549	8,424	(6,872)
Insurance net premium income	5,128	5,266	5,709
Non-interest income	17,659	19,638	5,248
Total income	31,868	33,026	20,730
Operating expenses	(18,228)	(17,417)	(35,065)
Profit/(loss) before other operating charges and impairment losses	13,640	15,609	(14,335)
Insurance net claims	(4,783)	(4,357)	(3,917)
Impairment losses	(9,256)	(13,899)	(7,439)
Operating loss before tax	(399)	(2,647)	(25,691)
Tax (charge)/credit	(634)	429	2,167
Loss from continuing operations	(1,033)	(2,218)	(23,524)
Loss from discontinued operations, net of tax	(633)	(105)	(11,018)
Loss for the year	(1,666)	(2,323)	(34,542)
Non-controlling interests	665	(349)	10,832
Other owners' dividends	(124)	(935)	(596)
Loss attributable to ordinary and B shareholders	(1,125)	(3,607)	(24,306)
Basic loss per ordinary and B share from continuing operations	(0.5p)	(6.3p)	(146.2p)

2010 compared with 2009

Operating loss
Operating loss before tax for the year was £399 million compared with a loss of £2,647 million in 2009. The improvement in performance is primarily driven by stronger Core Retail & Commercial operating profits offsetting more normal results from Global Banking & Markets, coupled with lower impairments in the Non-Core division.

After tax, non-controlling interests and preference share and other dividends, the loss attributable to ordinary and B shareholders was £1,125 million, compared with an attributable loss of £3,607 million in 2009.

Total income
Total income decreased 4% to £31,868 million reflecting the return to more normal levels in Global Banking & Markets, compared with the favourable market conditions seen in 2009. This was offset by good growth in Core Retail & Commercial and lower Non-Core trading losses as underlying asset prices recovered and credit spreads tightened.

Net interest income
Net interest income increased by 6% to £14,209 million reflecting improvements in net interest margin which more than offset lower interest-earning assets and interest-bearing liabilities. Group net interest margin increased from 1.83% to 2.06% largely reflecting expanding asset margins in UK Retail and UK Corporate divisions as well as in US Retail & Commercial. The run-off of low-yielding Non-Core assets also contributed to this increase. The Group net interest margin was also affected by increased funding costs.

Non-interest income
Non-interest income decreased to £17,659 million from £19,638 million in 2009. This included movements in the fair value of the Asset Protection Scheme - credit default swap resulting in a £1,550 million charge and gain on redemption of own debt of £553 million (2009 - £3,790 million). Excluding these items, non-interest income was up 18% primarily reflecting an increase in income from trading activities.

Operating expenses
Operating expenses increased to £18,228 million (2009 - £17,417 million). The main driver of this 5% increase was the impact of a £2,148 million gains on pension curtailment in 2009. This was partially offset by gains on the recognition of benefits from the Group-wide efficiency programme. The programme continues to deliver material savings which have been funding investments to strengthen our Core franchises. Annualised savings are now just ahead of the £2.5 billion target for 2011 and are forecast to exceed £3 billion by 2013. Integration and restructuring costs were £1,032 million compared with £1,286 million in 2009. Write-down of goodwill and other intangible assets was £10 million compared with £363 million in 2009. Premises and equipment costs fell by 7% in the year largely driven by efficiency cost savings, significant one-off property impairments recognised in 2009 and country exits following Non-Core disposals.

Net insurance claims
Bancassurance and general insurance claims, after reinsurance, increased by 10% to £4,783 million.

Impairment losses
Impairment losses were £9,256 million, compared with £13,899 million in 2009 with Core impairments falling by £898 million and Non-Core by £3,745 million. The decrease reflects an overall improvement in the economic

environment. Impairments fell in all businesses, except Ulster Bank, which has faced an economic environment that remains challenging.

Risk elements in lending and potential problem loans represented 7.4% of gross loans and advances to customers excluding reverse repos at 31 December 2010 (2009 - 5.5%).

Provision coverage of risk elements in lending and potential problem loans was 46% (2009 - 45%).

Tax
The tax charge for 2010 was £634 million compared with a tax credit of £429 million in 2009.

Earnings
Basic earnings per ordinary share, including discontinued operations, was a loss of 0.5p per share compared with a loss of 6.4p for 2009.

2009 compared with 2008

Operating loss

Operating loss before tax for the year was £2,647 million compared with a loss of £25,691 million in 2008. The reduction in the loss is primarily a result of a substantial increase in non-interest income and a substantial fall in the write-down of goodwill and other intangible assets partially offset by a significant increase in impairment losses and lower net interest income.

After tax, non-controlling interests and preference share and other dividends, the loss attributable to ordinary and B shareholders was £3,607 million, compared with an attributable loss of £24,306 million in 2008.

Total income

Total income increased 59% to £33,026 million in 2009 primarily reflecting a significant reduction in credit and other market losses and a gain on redemption of own debt. Increased market volatility and strong customer demand in a positive trading environment also contributed to this improvement. While income was down marginally in UK Corporate and held steady in Retail & Commercial Banking and RBS Insurance, a significant improvement occurred in Global Banking & Markets, reflecting the reduced credit and other market losses and a more buoyant trading market during the year compared to 2008.

Net interest income

Net interest income fell by 14% to £13,388 million, with average loans and advances to customers stable and average customer deposits down 1%. Group net interest margin fell from 2.12% to 1.83% largely reflecting the pressure on liability margins, given rates on many deposit products already at floors in the low interest rate environment, and strong competition, particularly for longer-term deposits and the build up of the Group's liquidity portfolio.

Non-interest income

Non-interest income increased to £19,638 million from £5,248 million in 2008, largely reflecting the sharp improvement in income from trading activities, as improved asset valuations led to lower credit market losses and GBM benefited from the restructuring of its business to focus on core customer franchises. The Group also recorded a gain of £3,790 million on a liability management exercise to redeem a number of Tier 1 and upper Tier 2 securities. However, fees and commissions fell as a result of the withdrawal of the single premium payment protection insurance product and the restructuring of UK current account overdraft fees, offset by higher fees in businesses attributable to RFS Holdings minority interest.

Operating expenses

Total operating expenses decreased from £35,065 million in 2008 to £17,417 million, largely resulting from the substantial decrease in the write-down of goodwill and other intangible assets, down to £363 million compared with £16,911 million in 2008. Staff costs, excluding curtailment gains, were up 12% with most of the movement relating to adverse movements in foreign exchange rates and some salary inflation. Changes in incentive compensation, primarily in Global Banking & Markets, represented most of the remaining change. This was offset by a gain of £2,148 million arising from the curtailment of prospective pension benefits in the defined benefit scheme and certain other subsidiary schemes. The Group cost:income ratio improved to 53%, compared with 169% in 2008.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, increased by 11% to £4,357 million.

Impairment losses
Impairment losses increased to £13,899 million from £7,439 million in 2008, with Core bank impairments rising by £2,182 million, Non-Core by £4,285 million off set by a decrease in RFS Holdings minority interest of £7 million. Signs that impairments might be plateauing appear to have been borne out in the latter part of the year, and there are indications that the pace of downwards credit rating migration for corporates is slowing. Nonetheless, the financial circumstances of many consumers and businesses remain fragile, and rising refinancing costs, whether as a result of monetary tightening or of increased regulatory capital requirements, could expose some customers to further difficulty.

Impairments represented 1.9% of gross loans and advances, excluding reverse repos, in 2009 compared with 0.8% in 2008.

Risk elements in lending and potential problem loans at 31 December 2009 represented 5.4% of loans and advances, excluding reverse repos, compared with 2.5% a year earlier. Provision coverage was 45%, compared with 51% at 31 December 2008 as a consequence of the growth in risk elements in lending being concentrated in secured, property-related loans. These loans require relatively lower provisions in view of their collateralised nature.

Tax
The effective tax rate for 2009 was 16.2% compared with 8.4% in 2008.

Earnings
Basic earnings per ordinary and B share, including discontinued operations, improved from a loss of 146.7p to a loss of 6.4p.

Analysis of results

Net interest income

	2010	2009	2008
	£m	£m	£m
Interest receivable	22,776	33,836	49,522
Interest payable	(8,567)	(17,332)	(30,847)
Net interest income	14,209	16,504	18,675
	%	%	%
Gross yield on interest-earning assets of the banking business (1)	3.30	3.76	5.61
Cost of interest-bearing liabilities of the banking business	(1.47)	(2.18)	(3.79)
Interest spread of the banking business (2)	1.83	1.58	1.82
Benefit from interest-free funds	0.23	0.25	0.30
Net interest margin of the banking business (3)	2.06	1.83	2.12

Yields, spreads and margins of the banking business	%	%	%
Gross yield (1)			
- Group	3.30	3.76	5.61
- UK	3.42	3.35	5.72
- Overseas	3.15	4.09	5.54
Interest spread (2)			
- Group	1.83	1.58	1.82
- UK	2.01	1.50	1.92
- Overseas	1.59	1.67	1.76
Net interest margin (3)			
- Group	2.06	1.83	2.12
- UK	2.22	1.81	2.39
- Overseas	1.84	1.85	1.91
The Royal Bank of Scotland plc base rate (average)	0.50	0.64	4.67
London inter-bank three month offered rates (average)			
- Sterling	0.70	1.21	5.51
- Eurodollar	0.34	0.69	2.92
- Euro	0.75	1.21	4.63

Notes:
(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.
(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

Average balance sheet and related interest

		2010			2009		
		Average balance	Interest	Rate	Average balance	Interest	Rate
		£m	£m	%	£m	£m	%
Assets							
Loans and advances to banks	- UK	22,714	222	0.98	21,616	310	1.43
	- Overseas	30,148	369	1.22	32,367	613	1.89
Loans and advances to customers	- UK	310,712	11,989	3.86	333,230	11,940	3.58
	- Overseas	195,858	6,900	3.52	376,382	16,339	4.34
Debt securities	- UK	66,765	1,459	2.19	52,470	1,414	2.69
	- Overseas	63,334	1,837	2.90	84,822	3,220	3.80
Interest-earning assets	- UK	400,191	13,670	3.42	407,316	13,664	3.35
	- Overseas	289,340	9,106	3.15	493,571	20,172	4.09
Total interest-earning assets	- banking business (2,3)	689,531	22,776	3.30	900,887	33,836	3.76
	- trading business (4)	276,330			291,092		
Interest-earning assets		965,861			1,191,979		
Non-interest-earning assets (2,3)		706,343			831,501		
Total assets		1,672,204			2,023,480		
Percentage of assets applicable to overseas operations		44.0%			47.4%		
Liabilities							
Deposits by banks	- UK	21,816	334	1.53	24,837	679	2.73
	- Overseas	59,799	999	1.67	104,396	2,362	2.26
Customer accounts: demand deposits	- UK	120,796	621	0.51	110,294	569	0.52
	- Overseas	39,127	607	1.55	82,177	1,330	1.62
Customer accounts: savings deposits	- UK	68,142	935	1.37	54,270	780	1.44
	- Overseas	25,587	213	0.83	83,388	2,114	2.54
Customer accounts: other time deposits	- UK	39,934	431	1.08	68,625	932	1.36
	- Overseas	43,996	914	2.08	71,315	2,255	3.16
Debt securities in issue	- UK	111,277	2,212	1.99	116,536	2,830	2.43
	- Overseas	72,175	1,065	1.48	117,428	2,500	2.13
Subordinated liabilities	- UK	19,442	398	2.05	26,053	834	3.20
	- Overseas	8,714	19	0.22	12,468	656	5.26
Internal funding of trading business	- UK	(41,451)	(140)	0.34	(60,284)	(317)	0.53
	- Overseas	(6,864)	(41)	0.60	(14,845)	(192)	1.29
Interest-bearing liabilities	- UK	339,956	4,791	1.41	340,331	6,307	1.85
	- Overseas	242,534	3,776	1.56	456,327	11,025	2.42
Total interest-bearing liabilities	- banking business (2,3)	582,490	8,567	1.47	796,658	17,332	2.18
	- trading business (4)	293,993			331,380		
Interest-bearing liabilities		876,483			1,128,038		
Non-interest-bearing liabilities:							
Demand deposits	- UK	46,692			38,220		
	- Overseas	23,994			27,149		
Other liabilities (3,4)		648,129			772,770		
Owners' equity		76,906			57,303		

Total liabilities and owners' equity	1,672,204	2,023,480
Percentage of liabilities applicable to overseas operations	41.7%	45.8%

Notes:
(1) The analysis into UK and Overseas has been compiled on the basis of location of office.
(2) Interest-earning assets and interest-bearing liabilities include the Retail bancassurance assets and liabilities attributable to policyholders.
(3) Interest income and interest expense do not include interest on financial assets and liabilities designated as at fair value through profit or loss.
(4) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

Average balance sheet and related interest continued

		2008		
		Average balance £m	Interest £m	Rate %
Assets				
Loans and advances to banks	- UK	19,039	939	4.93
	- Overseas	31,388	1,417	4.51
Loans and advances to customers	- UK	319,696	19,046	5.96
	- Overseas	393,405	22,766	5.79
Debt securities	- UK	33,206	1,276	3.84
	- Overseas	85,625	4,078	4.76
Interest-earning assets	- UK	371,941	21,261	5.72
	- Overseas	510,418	28,261	5.54
Total interest-earning assets	- banking business (2,3)	882,359	49,522	5.61
	- trading business (4)	425,454		
Interest-earning assets		1,307,813		
Non-interest-earning assets (2,3)		732,872		
Total assets		2,040,685		
Percentage of assets applicable to overseas operations		48.6%		
Liabilities				
Deposits by banks	- UK	46,217	1,804	3.90
	- Overseas	113,592	4,772	4.20
Customer accounts: demand deposits	- UK	99,852	2,829	2.83
	- Overseas	70,399	1,512	2.15
Customer accounts: savings deposits	- UK	42,870	1,708	3.98
	- Overseas	72,473	2,203	3.04
Customer accounts: other time deposits	- UK	94,365	4,011	4.25
	- Overseas	105,660	4,097	3.88
Debt securities in issue	- UK	101,520	4,095	4.03
	- Overseas	132,699	5,846	4.41
Subordinated liabilities	- UK	26,300	1,356	5.16
	- Overseas	12,385	788	6.36
Internal funding of trading business	- UK	(85,664)	(3,445)	4.02
	- Overseas	(18,090)	(729)	4.03
Interest-bearing liabilities	- UK	325,460	12,358	3.80
	- Overseas	489,118	18,489	3.78
Total interest-bearing liabilities	- banking business (2,3)	814,578	30,847	3.79
	- trading business (4)	466,610		
Interest-bearing liabilities		1,281,188		
Non-interest-bearing liabilities:				
Demand deposits	- UK	37,568		
	- Overseas	17,625		

Other liabilities (3,4)	645,760
Owners' equity	58,544
Total liabilities and owners' equity	2,040,685
Percentage of liabilities applicable to overseas operations	47.2%

Note:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.

(2) Interest-earning assets and interest-bearing liabilities include the Retail bancassurance assets and liabilities attributable to policyholders.

(3) Interest income and interest expense do not include interest on financial assets and liabilities designated as at fair value through profit or loss.

(4) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

Analysis of change in net interest income - volume and rate analysis

Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest-bearing liabilities. Changes due to a combination of volume and rate are allocated pro rata to volume and rate movements.

	2010 over 2009 Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m
Interest-earning assets			
Loans and advances to banks			
UK	15	(103)	(88)
Overseas	(40)	(204)	(244)
Loans and advances to customers			
UK	(836)	885	49
Overseas	(6,776)	(2,663)	(9,439)
Debt securities			
UK	342	(297)	45
Overseas	(716)	(667)	(1,383)
Total interest receivable of the banking business			
UK	(479)	485	6
Overseas	(7,532)	(3,534)	(11,066)
	(8,011)	(3,049)	(11,060)
Interest-bearing liabilities			
Deposits by banks			
UK	75	270	345
Overseas	845	518	1,363
Customer accounts: demand deposits			
UK	(54)	2	(52)
Overseas	670	53	723
Customer accounts: savings deposits			
UK	(192)	37	(155)
Overseas	965	936	1,901
Customer accounts: other time deposits			
UK	336	165	501
Overseas	708	633	1,341
Debt securities in issue			
UK	123	495	618
Overseas	799	636	1,435
Subordinated liabilities			
UK	180	256	436
Overseas	152	485	637
Internal funding of trading business			
UK	(83)	(94)	(177)
Overseas	(75)	(76)	(151)

Total interest payable of the banking business			
UK	385	1,131	1,516
Overseas	4,064	3,185	7,249
	4,449	4,316	8,765
Movement in net interest income			
UK	(94)	1,616	1,522
Overseas	(3,468)	(349)	(3,817)
	(3,562)	1,267	(2,295)

Note:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.

Analysis of change in net interest income - volume and rate analysis continued

	2009 over 2008 Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m
Interest-earning assets			
Loans and advances to banks			
UK	113	(742)	(629)
Overseas	43	(847)	(804)
Loans and advances to customers			
UK	775	(7,881)	(7,106)
Overseas	(949)	(5,478)	(6,427)
Debt securities			
UK	594	(456)	138
Overseas	(38)	(820)	(858)
Total interest receivable of the banking business			
UK	1,482	(9,079)	(7,597)
Overseas	(944)	(7,145)	(8,089)
	538	(16,224)	(15,686)
Interest-bearing liabilities			
Deposits by banks			
UK	683	442	1,125
Overseas	360	2,050	2,410
Customer accounts: demand deposits			
UK	(268)	2,528	2,260
Overseas	(228)	410	182
Customer accounts: savings deposits			
UK	(369)	1,297	928
Overseas	(306)	395	89
Customer accounts: other time deposits			
UK	881	2,198	3,079
Overseas	1,175	667	1,842
Debt securities in issue			
UK	(540)	1,805	1,265
Overseas	609	2,737	3,346
Subordinated liabilities			
UK	13	509	522
Overseas	(5)	137	132
Internal funding of trading business			
UK	(795)	(2,333)	(3,128)
Overseas	(112)	(425)	(537)
Total interest payable of the banking business			
UK	(395)	6,446	6,051

Overseas	1,493	5,971	7,464
	1,098	12,417	13,515
Movement in net interest income			
UK	1,087	(2,633)	(1,546)
Overseas	549	(1,174)	(625)
	1,636	(3,807)	(2,171)

Note:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.

16

Non-interest income

	2010 £m	2009 £m	2008 £m
Fees and commissions receivable	8,193	8,738	8,855
Fees and commissions payable	(2,211)	(2,790)	(2,444)
Income/(loss) from trading activities			
- excluding Asset Protection Scheme credit default swap - fair value changes	6,067	3,761	(9,025)
- Asset Protection Scheme credit default swap - fair value changes	(1,550)	—	—
Gain on redemption of own debt	553	3,790	—
Other operating income	1,479	873	2,153
Non-interest income (excluding insurance net premium income)	12,531	14,372	(461)
Insurance net premium income	5,128	5,266	5,709
Total non-interest income	17,659	19,638	5,248

2010 compared with 2009

Net fees and commissions increased by £34 million to £5,982 million primarily due to improved performance in GBM (£139 million), driven by higher portfolio management and origination income, and UK Corporate (£94 million), principally reflecting strong refinancing levels and increased operating lease activity This increase was partially offset by reduced fees in UK Retail (£160 million) and Ulster Bank (£72 million) principally reflecting the restructuring of current account overdraft fees.

Income from trading activities, excluding fair value movements in the Asset Protection Scheme credit default swap, rose substantially during the year by £2,306 million to £6,067 million. Trading revenues in GBM were lower than 2009, which saw unusually buoyant market conditions as rapidly falling interest rates generated significant revenue opportunities. This was more than offset by the improvement in Non-Core trading losses from £5,123 million for 2009 to £16 million for 2010 as underlying asset prices recovered and monoline spreads tightened. The unwinding of some banking book hedges also helped reduce trading losses.

The Asset Protection Scheme is accounted for as a credit derivative, and movements in the fair value of the contract are recorded as income from trading activities. The charge of £1,550 million in 2010 reflects improving credit spreads on the portfolio of covered assets.

A gain of £553 million was booked associated with the liability management exercise undertaken in May 2010, through which the Group strengthened its Core Tier 1 capital base by repurchasing existing Tier 1 securities and exchanging selected existing Upper Tier 2 securities for new senior debt securities. A similar series of exchange and tender offers concluded in April 2009 resulted in a gain of £3,790 million.

Other operating income increased by £606 million to £1,479 million. This improvement principally reflected a profit on sale of securities of £496 million compared with £162 million in 2009, higher profits from associated entities and an increased credit of £249 million compared with £51 million in 2009 relating to movements in fair value of own debt. These were partially offset by losses in the fair value of securities and investment properties.

Insurance net premium income fell by £138 million to £5,128 million principally reflecting lower general insurance premiums, driven by a managed reduction in the risk of the UK motor book, largely offset by price increases.

17

Non-interest income continued

2009 compared with 2008
Net fees and commissions fell by £463 million primarily due to the withdrawal of the single premium payment protection insurance product and the restructuring of current account overdraft fees within UK Retail during the year, as well as to reduced fees received in Non-Core. This was partially offset by improved performance in GBM (£171 million) and US Retail & Commercial (£50 million).

Income from trading activities rose substantially during the year by £12,786 million, principally due to lower credit market losses reflecting improved underlying asset prices compared with 2009. Increased market volatility and strong customer demand in a positive trading environment also contributed to this improvement.

In the second quarter of 2009 the Group recorded a gain of £3,790 million on a liability management exercise to redeem a number of Tier 1 and upper Tier 2 securities.

Other operating income decreased by £1,280 million. This reflected changes in the fair value of own debt of £926 million together with lower profits on sales of securities and properties and reduced dividend income. Included in 2008 is a gain of £600 million on the sale of Angel Trains.

Insurance net premium income fell by £443 million reflecting lower bancassurance fees, and lower general insurance premiums.

Operating expenses

	2010 £m	2009 £m	2008 £m
Staff costs			
- excluding gains on pensions curtailment	9,671	9,993	8,898
- gains on pensions curtailment	—	(2,148)	—
Premises and equipment	2,402	2,594	2,163
Other	3,995	4,449	4,716
Administrative expenses	16,068	14,888	15,777
Depreciation and amortisation	2,150	2,166	2,377
Write-down of goodwill and other intangible assets	10	363	16,911
Operating expenses	18,228	17,417	35,065
General insurance	4,698	4,223	3,733
Bancassurance	85	134	184
Insurance net claims	4,783	4,357	3,917
Staff costs as a percentage of total income	30%	30%	43%

2010 compared with 2009

The main driver of a 7% decrease in operating expenses, excluding gains on pensions curtailment, is the recognition of benefits from the Group-wide efficiency programme. The programme continues to deliver material savings which have been funding investments to strengthen our Core franchises. Annualised savings are now just ahead of the £2.5 billion target for 2011 and are forecast to exceed £3 billion by 2013.

Staff costs, excluding pension schemes curtailment gains, fell by £322 million to £9,671 million, driven by savings in Global Banking & Markets, UK Retail and Non-Core partially offset by higher costs in Group Centre.

Premises and equipment costs fell by 7% in the year to £2,402 million largely driven by efficiency cost savings, significant one-off property impairments recognised in 2009 and country exits following Non-Core disposals.

Other expenses fell by £454 million to £3,995 million principally reflecting continued savings from the Group’s efficiency programme.

Insurance net claims increased 10% to £4,783 million, driven by an overall increase in bodily injury reserves, reflecting prior year claims and more claims being settled as periodic payment orders. Severe weather experienced during Q1 and Q4 2010 also drove up claims in the year.

2009 compared with 2008

Staff costs, excluding pension schemes curtailment gains, were up £1,095 million with most of the movement relating to adverse movements in foreign exchange rates and some salary inflation. Changes in incentive compensation, primarily in Global Banking & Markets, represented most of the remaining change.

Pension curtailment gains of £2,148 million were recognised in 2009 arising from changes to prospective pension benefits in the defined benefit scheme and certain other subsidiary schemes.

Premises and equipment costs rose by £431 million primarily due to the impact of expanded Group premises in London and the US.

Other expenses fell by £267 million due to integration benefits in GBM partially offset by increased deposit insurance levies in the US.

19

Integration costs

	2010 £m	2009 £m	2008 £m
Staff costs	210	365	503
Premises and equipment	3	78	25
Other administrative expenses	143	398	486
Depreciation and amortisation	20	18	36
	376	859	1,050

2010 compared with 2009
Integration costs were £376 million compared with £859 million in 2009. The fall in integration costs primarily relates to RBS N.V. (formerly ABN AMRO), as they migrate onto RBS systems.

2009 compared with 2008
Integration costs in 2009 were £859 million compared with £1,050 million in 2008. Integration costs decreased primarily due to lower RBS N.V. (formerly ABN AMRO) integration activity during the year.

Accruals in relation to integration costs are set out below.

	At 31 December 2009 £m	Charge to income statement £m	Utilised during the year £m	At 31 December 2010 £m
Staff costs - redundancy	—	55	(55)	—
Staff costs - other	—	155	(155)	—
Premises and equipment	40	3	(19)	24
Other	1	163	(164)	—
	41	376	(393)	24

Restructuring costs

	2010 £m	2009 £m	2008 £m
Staff costs	353	328	251
Premises and equipment	117	48	15
Other administrative expenses	104	51	41
	574	427	307

2010 compared with 2009
Restructuring costs were £574 million compared with £427 million in 2009. The increase is a result of the number of restructuring projects being undertaken.

2009 compared with 2008
Restructuring costs were £427 million compared with £307 million in 2008. The number of restructuring projects increased during the year, as a result of ongoing strategic review being undertaken by the Group.

Accruals in relation to restructuring costs are set out below.

	At 31 December 2009	Charge to income statement	Utilised during the year	At 31 December 2010
	£m	£m	£m	£m
Staff costs - redundancy	255	255	(309)	201
Staff costs - other	4	98	(85)	17
Premises and equipment	37	117	(37)	117
Other	35	104	(93)	46
	331	574	(524)	381

Divestment costs

	2010 £m	2009 £m	2008 £m
Staff costs	51	—	—
Premises and equipment	6	—	—
Other administrative expenses	25	—	—
	82	—	—

2010 compared with 2009
Divestment costs of £82 million in the year relate to the European Commission mandated divestments.

Accruals in relation to divestment costs are set out below.

	At 31 December 2009 £m	Charge to income statement £m	Utilised during the year £m	At 31 December 2010 £m
Staff costs - redundancy	—	28	(6)	22
Staff costs - other	—	23	(15)	8
Premises and equipment	—	6	(6)	—
Other	—	25	(23)	2
	—	82	(50)	32

Impairment losses

	2010	2009	2008
	£m	£m	£m
New impairment losses	9,667	14,224	7,700
Less: recoveries of amounts previously written-off	(411)	(325)	(261)
Charge to income statement	9,256	13,899	7,439
Comprising:			
Loans and advances	9,144	13,090	6,478
Securities	112	809	961
Charge to income statement	9,256	13,899	7,439

2010 compared with 2009

Impairment losses were £9,256 million, compared with £13,899 million in 2009. The 33% decrease reflects an overall improvement in the economic environments in which the Group operates.

Impairments fell in all Core businesses, except Ulster Bank Group, which faced an economic environment that remains challenging, with rising default levels across both personal and corporate portfolios.

Impairments for Ulster Bank Group (Core and Non-Core) increased to £3,843 million compared with £1,927 million in 2009.

A significant proportion of the reduction in Core impairments relates to lower specific and latent provisions in UK Corporate, US Retail & Commercial and GBM.

Non-Core impairments fell by 41% in 2010 reflecting the gradual improvement in the economic environment through 2010 and lower specific provisions, alongside a non-repeat of the large single name losses seen in 2009.

2009 compared with 2008

Impairment losses were £13,899 million compared with £7,439 million. Impairment losses in the Core divisions increased by £2,182 million, Non-Core losses increased by £4,285 million off-set by a decrease in RFS Holdings minority interest of £7 million.

In the Core business, the biggest increases were in UK Retail, UK Corporate and Ulster Bank, reflecting the difficult economic environment.

Non-Core losses also increased substantially, particularly across the corporate and property sectors.

Credit market exposures

Credit and other market (losses)/gains (1)	2010 £m	2009 £m	2008 £m
Monoline exposures	(5)	(2,387)	(3,093)
CDPCs (2)	(141)	(957)	(615)
Asset-backed products	235	(288)	(4,778)
Other credit exotics	77	(558)	(947)
Equities	(17)	(47)	(948)
Leveraged finance	—	—	(1,088)
Banking book hedges	(82)	(1,727)	1,642
Other	(455)	(188)	(268)
Net credit and other market losses	(388)	(6,152)	(10,095)

Notes:
(1) Included in 'Income from trading activities', significantly all in Non-Core.
(2) Credit derivative product companies.

2010 compared with 2009
Tightening credit spreads, a recovery in underlying asset prices and gains on sales of asset-backed products during 2010 contributed to significantly lower losses in 2010. Unwinding of some banking book hedges in 2010 also resulted in lower losses. Monoline losses of £2,387 million in 2009 reflected the widening credit spreads and lower recovery rates. CDPC losses were higher in 2009 due to losses on market risk hedges.

Other losses include credit valuation and other reserves against derivative counterparties other than monolines and CDPCs. Losses increased due to rating downgrades as well as other losses on specific deals.

2009 compared with 2008
Losses relating to monoline exposures were £2,387 million in 2009 compared with £3,093 million in 2008.

- The credit quality of the monolines has continued to deteriorate and the level of CVA held against exposures to monoline counterparties has increased from 52% to 62% during the year. This was driven by a combination of wider credit spreads and lower recovery rates.

- The gross exposure to monoline counterparties has decreased primarily due to a combination of higher prices of underlying reference instruments and restructuring certain exposures.

- The increase in CVA resulting from the credit quality deterioration was partially offset by the decrease in CVA requirement following the reduction in gross exposure due to higher prices of underlying reference instruments. Consequently the net losses incurred in this regard were lower than in 2008 when there was both an increase in gross exposure and deterioration in credit quality.

Losses relating to CDPC exposures were £957 million in 2009 compared with £615 million in 2008.

- The credit quality of the CDPCs has continued to deteriorate and the level of CVA held against exposures to CDPC counterparties has increased from 27% to 39% during the year.

- The gross exposure to CDPC counterparties has reduced primarily due to a combination of tighter credit spreads of the underlying reference loans and bonds, and a decrease in the relative value of senior tranches compared with the underlying reference portfolios.

- The decrease in CVA requirement following the reduction in gross exposure was partially offset by the increase in CVA requirement resulting from the credit quality deterioration. Consequently there were net gains in this regard in 2009 compared with losses in 2008 when there was both an increase in gross exposure and deterioration in credit quality.

- Net losses were incurred in 2009 due to hedges put in place at the end of 2008 and during 2009 which effectively cap the exposure to certain CDPCs. As the exposure to these CDPCs has reduced, losses have been incurred on the hedges.

Losses relating to asset-backed products were £288 million in 2009 compared with £4,778 million in 2008.

- Losses reported in 2009 primarily relate to super senior CDOs. The significant price declines of the underlying predominantly mortgage-backed securities seen in 2008 were not repeated in 2009.

- Losses on other mortgage backed securities were greatly reduced in 2009 as many of these positions were sold or substantially written down in 2008 resulting in reduced net exposure in 2009.

Losses relating to other credit exotics were £558 million in 2009 compared with £947 million in 2008. These losses were reduced in 2009 as hedges were put in place to mitigate the risk.

Leveraged finance assets were reclassified on 1 July 2009. Changes in the fair value of these assets are only recognised in the income statement to the extent that they are considered impairments.

Losses relating to banking book hedges were £1,727 million in 2009 compared with profits of £1,642 million in 2008. These trades hedge counterparty risk that arises from loans and bonds on the regulatory banking book. As credit spreads have generally tightened in 2009 the value of these hedges has decreased resulting in losses. These hedges gave rise to gains in 2008 due to credit spreads generally widening.

Credit market exposures continued
Additional disclosures on these and other related exposures can be found in the following sections:

Disclosure	Section	Sub-section	Page
Further analysis of credit market exposures	Risk and balance sheet management	Other risk exposures	144
Valuation aspects	Financial statements	Note 12 Financial instruments - valuation	251
	Financial statements	Critical accounting policies	225
Reclassification of financial instruments	Financial statements	Note 11 Financial instruments - classification	247

Tax

	2010	2009	2008
	£m	£m	£m
Tax (charge)/credit	(634)	429	2,167
	%	%	%
UK corporation tax rate	28.0	28.0	28.5
Effective tax rate	nm	16.2	8.4

nm = not meaningful

The actual tax (charge)/credit differs from the expected tax credit computed by applying the standard rate of UK corporation tax as follows:

	2010	2009	2008
	£m	£m	£m
Expected tax credit	112	741	7,322
Non-deductible goodwill impairment	(3)	(102)	(3,826)
Unrecognised timing differences	11	274	(274)
Items not allowed for tax			
- losses on strategic disposals and write downs	(311)	(152)	(108)
- other	(328)	(356)	(270)
Non-taxable items			
- gain on sale of Global Merchant Services	221	—	—
- gain on redemption of own debt	11	693	—
- other	341	410	491
Taxable foreign exchange movements	4	1	(80)
Foreign profits taxed at other rates	(517)	(276)	(509)
UK tax rate change - deferred tax impact	(82)	—	—
Losses in year where no deferred tax asset recognised	(450)	(780)	(942)
Losses brought forward and utilised	2	94	11
Adjustments in respect of prior years	355	(118)	352
Actual tax (charge)/credit	(634)	429	2,167

2010 compared with 2009
The high tax charge in 2010 reflects profits in high tax regimes and losses in low tax regimes, together with £450 million relating to losses in overseas subsidiaries for which a deferred tax asset has not been recognised, and £311 million mainly in respect of losses on disposal of businesses for which no tax relief is available. This was offset in part by the non-taxable gain arising on the disposal of 80.01% of the GMS business.

2009 compared with 2008
The low tax credit in 2009 reflects profits in high tax regimes and losses in low tax regimes, together with £780 million relating to losses in overseas subsidiaries for which a deferred tax asset has not been recognised, and £152 million mainly in respect of losses on disposal of business for which no tax relief is available.

Divisional performance

The results of each division are set out below. The results are stated before fair value of own debt, amortisation of purchased intangible assets, integration and restructuring costs, gain on redemption of own debt, strategic disposals, bonus tax, Asset Protection Scheme credit default swap - fair value changes, gains on pensions curtailment, write-down of goodwill and other intangible assets and RFS Holdings minority interest.

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

Group Centre directly attributable costs have been allocated to the operating divisions, based on their service usage. Where services span more than one division, the costs are allocated on a basis management considers reasonable. The residual unallocated costs remaining in the Group Centre relate to volatile corporate items that do not naturally reside within a division.

Treasury costs are allocated to operating divisions as follows: term funding costs are allocated or rewarded based on long term funding gap or surplus; liquidity buffer funding costs are allocated based on share of overall liquidity buffer derived from divisional stresses; and capital cost or benefit is allocated based on share of divisional risk-adjusted risk-weighted assets (RWAs).

	2010 £m	2009 £m	2008 £m
UK Retail	1,372	229	723
UK Corporate	1,463	1,125	1,781
Wealth	304	420	348
Global Transaction Services	1,088	973	1,002
Ulster Bank	(761)	(368)	218
US Retail & Commercial	306	(113)	528
Retail & Commercial	3,772	2,266	4,600
Global Banking & Markets	3,364	5,758	(2,153)
RBS Insurance	(295)	58	584
Central items	577	385	150
Core	7,418	8,467	3,181
Non-Core	(5,505)	(14,557)	(11,351)
	1,913	(6,090)	(8,170)
Reconciling items:			
Fair value of own debt	174	(142)	1,232
RFS Holdings minority interest	(150)	(356)	(484)
Amortisation of purchased intangible assets	(369)	(272)	(443)
Integration and restructuring costs	(1,032)	(1,286)	(1,357)
Gain on redemption of own debt	553	3,790	—
Strategic disposals	171	132	442
Gains on pensions curtailment	—	2,148	—
Bonus tax	(99)	(208)	—
Asset Protection Scheme credit default swap - fair value changes	(1,550)	—	—

Write-down of goodwill and other intangible assets	(10)	(363)	(16,911)
Group operating loss before tax	(399)	(2,647)	(25,691)

Business review continued

Business review

Divisional performance continued

Impairment losses by division	2010 £m	2009 £m	2008 £m
UK Retail	1,160	1,679	1,019
UK Corporate	761	927	319
Wealth	18	33	16
Global Transaction Services	9	39	54
Ulster Bank	1,161	649	106
US Retail & Commercial	517	702	437
Retail & Commercial	3,626	4,029	1,951
Global Banking & Markets	151	640	522
RBS Insurance	—	8	42
Central items	3	1	(19)
Core	3,780	4,678	2,496
Non-Core	5,476	9,221	4,936
	9,256	13,899	7,432
Reconciling item:			
RFS Holdings minority interest	—	—	7
Group	9,256	13,899	7,439

Net interest margin by division	2010 %	2009 %	2008 %
UK Retail	3.91	3.59	3.58
UK Corporate	2.51	2.22	2.40
Wealth	3.37	4.38	4.51
Global Transaction Services	6.73	9.22	8.25
Ulster Bank	1.84	1.87	1.89
US Retail & Commercial	2.85	2.37	2.68
Retail & Commercial	3.14	2.89	3.00
Global Banking & Markets	1.05	1.38	1.34
Non-Core	1.16	0.69	0.87
Group	2.06	1.83	2.12

Risk-weighted assets by division	2010 £bn	2009 £bn	2008 £bn
UK Retail	48.8	51.3	45.7
UK Corporate	81.4	90.2	85.7
Wealth	12.5	11.2	10.8
Global Transaction Services	18.3	19.1	17.4
Ulster Bank	31.6	29.9	24.5
US Retail & Commercial	57.0	59.7	63.9
Retail & Commercial	249.6	261.4	248.0

Global Banking & Markets	146.9	123.7	151.8
Other	18.0	9.4	7.1
Core	414.5	394.5	406.9
Non-Core	153.7	171.3	170.9
Group before benefit of Asset Protection Scheme	568.2	565.8	577.8
Benefit of Asset Protection Scheme	(105.6)	(127.6)	—
Group before RFS Holdings minority interest	462.6	438.2	577.8
RFS Holdings minority interest	2.9	102.8	118.0
Group	465.5	541.0	695.8

Employee numbers at 31 December
(full time equivalents in continuing operations rounded to the nearest hundred)

	2010	2009	2008
UK Retail	23,800	25,500	28,400
UK Corporate	13,100	12,300	13,400
Wealth	5,200	4,600	5,200
Global Transaction Services	2,600	3,500	3,900
Ulster Bank	4,200	4,500	5,400
US Retail & Commercial	15,700	15,500	16,200
Retail & Commercial	64,600	65,900	72,500
Global Banking & Markets	18,700	17,900	17,500
RBS Insurance	14,500	13,900	14,500
Central items	4,700	4,200	4,300
Core	102,500	101,900	108,800
Non-Core	6,900	15,100	19,000
	109,400	117,000	127,800
Business services	38,800	43,100	46,600
Integration	300	500	900
RFS Holdings minority interest	—	300	200
Group	148,500	160,900	175,500

UK Retail

	2010 £m	2009 £m	2008 £m
Net interest income	4,078	3,452	3,187
Net fees and commissions	1,160	1,320	1,577
Other non-interest income	252	309	358
Non-interest income	1,412	1,629	1,935
Total income	5,490	5,081	5,122
Direct expenses			
- staff	(778)	(845)	(924)
- other	(474)	(453)	(548)
Indirect expenses	(1,621)	(1,741)	(1,724)
	(2,873)	(3,039)	(3,196)
Insurance net claims	(85)	(134)	(184)
Impairment losses	(1,160)	(1,679)	(1,019)
Operating profit	1,372	229	723
Analysis of income by product			
Personal advances	993	1,192	1,244
Personal deposits	1,102	1,349	2,037
Mortgages	1,984	1,214	500
Bancassurance	314	380	401
Cards	962	869	831
Other	135	77	109
Total income	5,490	5,081	5,122
Analysis of impairment by sector			
Mortgages	177	124	31
Personal	682	1,023	568
Cards	301	532	420
Total impairment losses	1,160	1,679	1,019
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	0.2%	0.1%	—
Personal	5.8%	7.5%	3.7%
Cards	4.9%	8.6%	6.7%
	1.1%	1.6%	1.1%
Performance ratios			
Return on equity (1)	18.0%	3.0%	11.1%
Net interest margin	3.91%	3.59%	3.58%
Cost:income ratio	52%	60%	62%
Adjusted cost:income ratio (2)	53%	61%	65%

	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	90.6	83.2	72.2
- personal	11.7	13.6	15.3
- cards	6.1	6.2	6.3
	108.4	103.0	93.8
Customer deposits (excluding bancassurance)	96.1	87.2	78.9
Assets under management (excluding deposits)	5.7	5.3	5.7
Risk elements in lending	4.6	4.6	3.8
Loan:deposit ratio (excluding repos)	110%	115%	116%
Risk-weighted assets	48.8	51.3	45.7

Notes:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Adjusted cost:income ratio is based on total income after netting insurance claims, and operating expenses.

28

UK Retail continued

2010 compared with 2009
Operating profit recovered strongly from the low levels recorded in 2008 and 2009 to £1,372 million. Profit before impairments was up £624 million or 33% and impairments fell by £519 million as the economic environment continued to recover.

The division has continued to focus in 2010 on growing secured lending while at the same time building customer deposits, thereby reducing the Group’s reliance on wholesale funding. Loans and advances to customers grew 5%, with a change in mix from unsecured to secured as the Group actively sought to improve its risk profile. Mortgage balances grew by 9% while unsecured lending contracted by 10%.

- Mortgage growth was due to good retention of existing customers and new business, the majority of which comes from the existing customer base. Gross mortgage lending market share remained broadly in line with 2009 at 12%, with the Group on track to meet its Government target on net mortgage lending.

- Customer deposits grew 10% on 2009, reflecting the strength of the UK Retail customer franchise, which outperformed the market in an increasingly competitive environment. Savings balances grew by £8 billion or 13% with 1.8 million accounts opened, outperforming the market total deposit growth of 3%. Personal current account balances increased by 3% on 2009.

Net interest income increased significantly by 18% to £4,078 million, driven by strong balance sheet growth and repricing. Net interest margin improved by 32 basis points to 3.91%, with widening asset margins partially offset by contracting liability margins in the face of a competitive deposit market.

Non-interest income declined 13% to £1,412 million, principally reflecting the restructuring of current account overdraft fees in the final quarter of 2009.

Expenses decreased by 5%, with the cost:income ratio (net of insurance claims) improving from 61% to 53%.

- Direct staff costs declined by 8%, largely driven by a clear management focus on process re-engineering enabling a 7% reduction in headcount.

- RBS continues to progress towards a more convenient, lower cost operating model, with over 4.8 million active users of online banking and a record share of new sales achieved through direct channels. More than 7.8 million accounts have switched to paperless statements and 276 branches now utilise automated cash deposit machines.

Impairment losses decreased 31% to £1,160 million primarily reflecting the recovery in the economic environment.

- The mortgage impairment charge was £177 million (2009 - £124 million) on a total book of £91 billion. Mortgage arrears rates marginally increased in 2010 but remain below the industry average, as reported by the Council of Mortgage Lenders. Repossessions showed only a small increase on 2009, as the Group continues to support customers facing financial difficulties.

- The unsecured lending impairment charge was £983 million (2009 - £1,555 million) on a total book of £18 billion.

Risk-weighted assets decreased by 5% to £48.8 billion, with lower unsecured lending, improving portfolio credit metrics and small procyclicality benefits more than offsetting growth in mortgages.

29

UK Retail continued

2009 compared with 2008
Operating profit of £229 million was £494 million lower than in 2008. Profit before impairments was up £166 million or 10%, but impairments rose by £660 million as the economic environment deteriorated, albeit with signs of conditions stabilising in the second half of the year.

The division has focused in 2009 on growing secured lending to meet its Government targets while at the same time building customer deposits, thereby reducing the Group's reliance on wholesale funding. Loans and advances to customers grew 10%, with a change in mix from unsecured to secured as the Group sought actively to reduce its risk profile, with 15% growth in mortgage lending and an 8% reduction in unsecured lending.

- Mortgage growth was due to good retention of existing customers and new business sourced predominantly from the existing customer base. Gross mortgage lending market share increased to 12% from 7% in 2008, with the Group on track to exceed its Government targets on net lending by £3 billion.

- Customer deposits grew 11% on 2008 reflecting the strength of the UK Retail customer franchise, which outperformed the market in an increasingly competitive environment. Savings balances grew by £6 billion or 11% and account acquisition saw a 20% increase, with 2.2 million accounts opened. Personal current account balances increased by 12% on 2008 with a 3% growth in accounts to 12.8 million.

Net interest income increased significantly by 8% to £3,452 million, driven by strong balance sheet growth. Net interest margin was flat at 3.59%, with decreasing liability margins in the face of stiff competition for deposits offsetting wider asset margins. The growth in mortgages and the reduction in higher margin unsecured balances also had a negative impact on the blended net interest margin.

Non-interest income declined 16% to £1,629 million, principally reflecting the withdrawal of the single premium payment protection insurance product and the restructuring of current account overdraft fees in the final quarter of 2009, with the annualised impact of the overdraft fee restructuring further affecting income in 2010. The weak economic environment presented little opportunity in 2009 to grow credit card, private banking and bancassurance fees.

Expenses decreased by 5%, with the cost:income ratio improving from 62% to 60%.

- Direct staff costs declined by 9%, as the division benefited from strong cost control, a focus on process re-engineering and a 10% reduction in headcount.

- RBS continues to progress towards a more convenient, lower cost operating model, with over 4 million active users of online banking and a record share of new sales achieved through direct channels. More than 5.5 million accounts have switched to paperless statements and 254 branches now utilise automated cash deposit machines.

Impairment losses increased 65% to £1,679 million reflecting the deterioration in the economic environment, and its impact on customer finances.

- The mortgage impairment charge was £124 million (2008 - £31 million) on a total book of £83.2 billion. Mortgage arrears rates stabilised in the second half of 2009 and remain well below the industry average, as reported by the

Council of Mortgage Lenders. Repossessions show only a small increase on 2008, as the Group continues to support customers facing financial difficulties.

- The unsecured lending impairment charge was £1,555 million (2008 - £988 million) on a book of £19.8 billion. Industry benchmarks for cards arrears showed a slightly improving trend in the final quarter of 2009, which is consistent with the Group's experience. RBS continues to perform better than the market on arrears.

Risk-weighted assets increased by 12% to £51.3 billion due to higher lending and the upward pressure from procyclicality, more than offsetting the adoption of a through-the-cycle loss given default approach for mortgages.

UK Corporate

	2010 £m	2009 £m	2008 £m
Net interest income	2,572	2,292	2,448
Net fees and commissions	952	858	829
Other non-interest income	371	432	460
Non-interest income	1,323	1,290	1,289
Total income	3,895	3,582	3,737
Direct expenses			
- staff	(778)	(753)	(801)
- other	(359)	(260)	(318)
Indirect expenses	(534)	(517)	(518)
	(1,671)	(1,530)	(1,637)
Impairment losses	(761)	(927)	(319)
Operating profit	1,463	1,125	1,781
Analysis of income by business			
Corporate and commercial lending	2,598	2,131	2,094
Asset and invoice finance	617	501	312
Corporate deposits	728	986	1,266
Other	(48)	(36)	65
Total income	3,895	3,582	3,737
Analysis of impairment by sector			
Banks and financial institutions	20	15	9
Hotels and restaurants	52	98	25
House building and construction	131	106	42
Manufacturing	1	51	14
Other	127	150	53
Private sector education, health, social work, recreational and community services	30	59	15
Property	245	259	24
Wholesale and retail trade, repairs	91	76	37
Asset and invoice finance	64	113	100
Total impairment losses	761	927	319
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Banks and financial institutions	0.3%	0.2%	0.2%
Hotels and restaurants	0.8%	1.5%	0.4%
House building and construction	2.9%	2.5%	0.8%
Manufacturing	—	0.9%	0.3%
Other	0.4%	0.5%	0.1%
Private sector education, health, social work, recreational and community services	0.3%	0.9%	0.2%
Property	0.8%	0.8%	0.1%

Wholesale and retail trade, repairs	0.9%	0.7%	0.4%
Asset and invoice finance	0.6%	1.3%	1.2%
	0.7%	0.8%	0.3%
Performance ratios			
Return on equity (1)	12.1%	9.4%	15.9%
Net interest margin	2.51%	2.22%	2.40%
Cost:income ratio	43%	43%	44%

Note:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).

31

UK Corporate continued

	2010 £bn	2009 £bn	2008 £bn
Capital and balance sheet			
Total third party assets	114.6	114.9	121.0
Loans and advances to customers (gross)			
- banks and financial institutions	6.1	6.3	5.4
- hotels and restaurants	6.8	6.7	6.1
- housebuilding and construction	4.5	4.3	5.2
- manufacturing	5.3	5.9	5.3
- other	31.0	29.9	38.1
- private sector education, health, social work, recreational and community services	9.0	6.5	7.4
- property	29.5	33.0	31.8
- wholesale and retail trade, repairs	9.6	10.2	9.1
- asset and invoice finance	9.9	8.8	8.5
	111.7	111.6	116.9
Customer deposits	100.0	87.8	82.0
Risk elements in lending	4.0	2.3	1.3
Loan:deposit ratio (excluding repos)	110%	126%	142%
Risk-weighted assets	81.4	90.2	85.7

2010 compared with 2009

Operating profit grew by £338 million, 30%, compared with 2009, driven by strong income growth and significantly lower impairments, partially offset by higher costs.

UK Corporate performed strongly in the deposit market, with customer deposit balance growth of £12 billion contributing to a 16 percentage point improvement in the loan to deposit ratio in 2010. While customer lending increased only marginally (with gross lending largely offset by customer deleveraging) net interest income rose by £280 million, 12%, and net interest margin rose by 29 basis points driven primarily by the good progress made on loan repricing.

Non-interest income increased 3% reflecting strong refinancing levels and increased operating lease activity, partially offset by lower sales of financial market products.

Total costs increased 9% (£141 million) or 5% excluding the OFT penalty in 2010, legal recovery in 2009 and the normalisation of staff compensation phasing.

Impairments were 18% lower, primarily as a result of higher charges taken during the first half of 2009 to reflect potential losses in the portfolio not yet specifically identified.

Return on equity increased from 9.4% to 12.1%, reflecting higher operating profit and lower RWAs as a result of improved risk metrics.

2009 compared with 2008

Operating profit of £1,125 million was £656 million lower than in 2008, largely due to an increase of £608 million in impairments.

Net interest margin levels were rebuilt during the second half as asset pricing was amended to reflect increased funding and credit costs. For the year as a whole net interest margin was 18 basis points lower than in 2008, reflecting higher funding costs and continued competitive pricing for deposits.

Gross new lending to customers remained resilient in 2009, with a noticeable acceleration of lending activity in the second half of the year. However, as customers have deleveraged and turned increasingly to capital markets, repayments have accelerated even more sharply. Loans and advances to customers, therefore, declined by 5% to £111.6 billion.

Initiatives aimed at increasing customer deposits have been successful, with balance growth of 7%, although margins declined as a result of increased competition for balances.

Non-interest income was flat, with stable fee income from refinancing and structuring activity.

A reduction in costs of 7% was driven by lower staff expenses as a result of the Group's restructuring programme, together with restraint on discretionary spending levels.

Impairment losses increased substantially reflecting both a rise in the number of corporate delinquencies requiring a specific impairment and a higher charge to recognise losses not yet specifically identified.

Risk-weighted assets grew 5% despite the fall in customer lending, reflecting the impact of procyclicality, which was most pronounced in the first half of 2009.

Wealth

	2010 £m	2009 £m	2008 £m
Net interest income	609	663	578
Net fees and commissions	376	363	405
Other non-interest income	71	83	76
Non-interest income	447	446	481
Total income	1,056	1,109	1,059
Direct expenses			
- staff	(382)	(357)	(377)
- other	(142)	(144)	(178)
Indirect expenses	(210)	(155)	(140)
	(734)	(656)	(695)
Impairment losses	(18)	(33)	(16)
Operating profit	304	420	348
Analysis of income			
Private banking	857	916	819
Investments	199	193	240
Total income	1,056	1,109	1,059
Performance ratios			
Return on equity (1)	18.9%	30.3%	27.3%
Net interest margin	3.37%	4.38%	4.51%
Cost:income ratio	70%	59%	66%
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	7.8	6.5	5.3
- personal	6.7	4.9	5.0
- other	1.6	2.3	2.1
	16.1	13.7	12.4
Customer deposits	36.4	35.7	34.1
Assets under management (excluding deposits)	32.1	30.7	34.7
Risk elements in lending	0.2	0.2	0.1
Loan:deposit ratio (excluding repos)	44%	38%	36%
Risk-weighted assets	12.5	11.2	10.8

Note:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).

Wealth continued

2010 compared with 2009
2010 operating profit fell by 28% driven by lower net interest income and higher expenses, partly offset by a 45% decline in impairments in the year.

Income declined by 5% primarily due to lower net interest income. Strong lending and investment income was offset by the impact of a competitive deposit market.

Expenses grew by 12% to £734 million. Direct expenses were up 5%, £23 million reflecting additional strategic investment. Indirect expenses increased by £55 million reflecting a change in allocation of Business Services costs.

Assets under management grew by 5% largely through improving market conditions. On a constant currency basis, assets fell 2% with valuation gains being offset by client losses in the international businesses, resulting from the private banker attrition previously experienced.

2009 compared with 2008
Wealth produced strong growth in operating profit, up 21% to £420 million, reflecting the increased value of the division's healthy deposit base in an increasingly competitive market for funding. Deposit balances increased by 5% from 2008, though the deposit market remains highly competitive.

Total income was up 5% (1% in constant currency terms), with strong growth in net interest income, up 15% (12% in constant currency terms) reflecting the increased internal pricing applied to Wealth's deposit base. This was offset by a marked decrease in investment income year on year as assets under management decreased by 12% (8% at constant exchange rates) during 2009, with investors turning to more liquid assets and away from longer term investments.

Loans and advances increased by 10% over 2008, primarily in the UK. Lending margins improved, particularly for mortgages, and credit metrics for new business remain satisfactory.

Expenses were down 6% (10% lower on a constant currency basis), reflecting a rigorous focus on cost management, with staff costs decreasing by 5% as a result of planned headcount reduction. The cost:income ratio improved from 66% to 59%.

Impairments increased by £17 million over 2008 reflecting some isolated difficulties in the UK and offshore mortgage books (representing mortgages for second properties for expatriates). Provisions as a percentage of lending to customers increased slightly to 0.25%.

Global Transaction Services

	2010	2009	2008
	£m	£m	£m
Net interest income	974	912	937
Non-interest income	1,587	1,575	1,494
Total income	2,561	2,487	2,431
Direct expenses			
- staff	(411)	(371)	(362)
- other	(159)	(161)	(149)
Indirect expenses	(894)	(943)	(864)
	(1,464)	(1,475)	(1,375)
Impairment losses	(9)	(39)	(54)
Operating profit	1,088	973	1,002
Analysis of income by product			
Domestic cash management	818	805	795
International cash management	801	734	722
Trade finance	309	290	241
Merchant acquiring	451	505	527
Commercial cards	182	153	146
Total income	2,561	2,487	2,431
Performance ratios			
Return on equity (1)	42.8%	42.2%	44.6%
Net interest margin	6.73%	9.22%	8.25%
Cost:income ratio	57%	59%	57%
	£bn	£bn	£bn
Capital and balance sheet			
Total third party assets	25.2	18.4	22.2
Loans and advances	14.4	12.7	14.8
Customer deposits	69.9	61.8	61.8
Risk elements in lending	0.1	0.2	0.1
Loan:deposit ratio (excluding repos)	21%	21%	25%
Risk-weighted assets	18.3	19.1	17.4

Note:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).

Global Transaction Services continued

2010 compared with 2009
Operating profit increased 12%, or 10% on a constant foreign exchange basis, driven by a robust income performance (which has more than compensated for the loss of Global Merchant Services (GMS) income), good cost control and lower impairments. Adjusting for the disposal operating profit increased 21%.

For the eleven months before disposal, GTS booked income of £451 million and total expenses of £244 million for GMS, generating an operating profit of £207 million.

Income was up 3%, or 6% excluding GMS, reflecting higher deposit volumes in the International Cash Management business, growth in the Trade Finance business and improved Commercial Card transaction volumes.

Expenses were broadly in line with 2009, at £1,464 million, as increased investment in front office and support infrastructure was mitigated by tight management of business costs.

Third party assets increased by £6.8 billion, or £7.6 billion excluding GMS, as Yen clearing activities were brought in-house and loans and advances increased.

2009 compared with 2008
Operating profit declined by 3%, or 6% at constant foreign exchange rates, largely reflecting pressure on deposit income. The attrition of deposit balances experienced in the first half was reversed in the second, but margins remain compressed due to both a very competitive deposit market as well as the low rate environment.

Customer deposit balances at £61.8 billion were flat on the previous year, with growth in the UK and international business offset by weaker US domestic balances. At constant exchange rates balances were up 3%. Loans and advances were down 14% (11% in constant currency terms) due to reduced overdraft utilisation and lower trade volumes.

International payment fees increased by 2%, or 11% at constant exchange rates, while trade finance income increased by 20%, or 8% at constant exchange rates, with improved penetration in the Asia-Pacific region. Merchant acquiring income, however, declined by 4%, or 9% at constant exchange rates, as consumers continued to switch to lower margin debit card transactions in preference to using credit cards.

Expenses were up 7% in headline terms but flat in constant currency terms, as cost savings and efficiencies helped to mitigate the impact of investment in infrastructure. Staff expenses were up 2%, but 2% lower in constant currency terms, with headcount down 5%. The cost:income ratio was 59%, a deterioration of 2.7 percentage points or 1.9 percentage points in constant currency terms.

Impairment losses were £39 million, down £15 million versus 2008. Overall defaults remain modest at 0.3% of loans and advances.

Ulster Bank

	2010 £m	2009 £m	2008 £m
Net interest income	761	780	708
Net fees and commissions	156	228	238
Other non-interest income	58	26	93
Non-interest income	214	254	331
Total income	975	1,034	1,039
Direct expenses			
- staff	(237)	(325)	(330)
- other	(74)	(86)	(100)
Indirect expenses	(264)	(342)	(285)
	(575)	(753)	(715)
Impairment losses	(1,161)	(649)	(106)
Operating (loss)/profit	(761)	(368)	218
Analysis of income by business			
Corporate	521	580	618
Retail	465	412	396
Other	(11)	42	25
Total income	975	1,034	1,039
Analysis of impairment by sector			
Mortgages	294	74	17
Corporate			
- property	375	306	37
- other corporate	444	203	7
Other lending	48	66	45
Total impairment losses	1,161	649	106
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	1.4%	0.5%	0.1%
Corporate			
- property	6.9%	3.0%	0.3%
- other corporate	4.9%	1.8%	0.1%
Other lending	3.7%	2.7%	2.1%
	3.1%	1.6%	0.2%
Performance ratios			
Return on equity (1)	(21.0%)	(11.7%)	8.9%
Net interest margin	1.84%	1.87%	1.89%
Cost:income ratio	59%	73%	69%

Note:

(1) Divisional return on equity is based on divisional operating (loss)/profit after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).

Ulster Bank continued

	2010 £bn	2009 £bn	2008 £bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	21.2	16.2	18.1
- corporate			
- property	5.4	10.1	10.9
- other corporate	9.0	11.0	12.9
- other lending	1.3	2.4	2.1
	36.9	39.7	44.0
Customer deposits	23.1	21.9	24.3
Risk elements in lending			
- mortgages	1.5	0.6	0.3
- corporate			
- property	0.7	0.7	0.5
- other corporate	1.2	0.8	0.3
- other lending	0.2	0.2	0.1
	3.6	2.3	1.2
Loan:deposit ratio (excluding repos)	152%	177%	179%
Risk-weighted assets	31.6	29.9	24.5

2010 compared with 2009

Overall performance deteriorated in 2010, largely as a result of an increase in impairment losses of £512 million. Operating profit before impairment increased to £400 million, up 42%, or 50% in constant currency terms, driven by the culmination of a bank-wide cost saving programme during 2010.

Net interest income decreased by 2%, but increased by 1% on a constant currency basis as actions to increase asset margins were largely eroded by tightening deposit margins due to intensive market competition.

Non-interest income was 16% lower, or 14% on a constant currency basis reflecting a non-recurring gain in 2009.

Loans to customers fell by 7%, or 5% in constant currency terms. On 1 July 2010 the division transferred a portfolio of development property assets to the Non-Core division, partially offset by a simultaneous transfer of a portfolio of retail mortgage assets to the core business.

Despite intense competition, customer deposit balances increased by 5%, or 8% in constant currency terms over the year with strong growth across all deposit categories, driven by a focus on improving the bank’s funding profile.

Expenses were 24% lower, 22% lower at constant exchange rates. The strong year-on-year performance in expenses was primarily driven by an increased focus on active management of the cost base, and the benefits derived from the business restructuring and cost-saving programme which commenced in 2009.

Impairment losses increased by £512 million to £1,161 million reflecting the deteriorating economic environment in Ireland and rising default levels across both personal and corporate portfolios. Lower asset values, particularly in property-related lending together with pressure on borrowers with a dependence on consumer spending have resulted in higher corporate loan losses, while higher unemployment, lower incomes and increased taxation have driven mortgage impairment increases.

Risk-weighted assets have increased due to deteriorating credit risk metrics.

Customer numbers increased by 3% during 2010, with a strong performance in current and savings accounts switchers.

2009 compared with 2008

Operating results were in line with expectations but deteriorated during 2009 as economic conditions across the island of Ireland worsened, with an operating loss for the year of £368 million.

Net interest income increased by 10% reflecting movements in foreign exchange rates and asset repricing initiatives, largely offset by the tightening of deposit margins in an increasingly competitive market. Net interest margin for the year at 1.87% remained broadly stable despite the challenging market conditions.

Loans to customers decreased by 10% from the prior year as new business demand weakened. Customer deposits reduced by 10% in 2009, reflecting an increasingly competitive Irish deposit market and reductions in wholesale funding during the first quarter. During the second half of the year the market stabilised and the division recorded strong growth in customer balances resulting in an improved funding profile.

Non-interest income declined by 23% due to lower fee income driven by reduced activity levels across all business lines.

Total costs for the year increased by 5%. Direct expenses were down 3% during 2009, driven by the bank’s restructuring programme, which
incorporates the merger of the First Active and Ulster Bank businesses. The rollout of the programme has resulted in a downward trend in direct
expenses throughout 2009. The reduction in direct expenses has been offset by a 17% increase in indirect expenses primarily reflecting provisions relating to the bank’s own property recognised in the fourth quarter.

Impairment losses increased to £649 million from £106 million driven by the continued deterioration in the Irish economic environment and resultant impact on loan performance across the retail and wholesale portfolios.

Necessary fiscal budgetary action allied to the well-entrenched downturn in property markets in Ireland has fed through to higher loan losses. Mortgage impairments have been driven by rising unemployment and lower incomes. Loans to the property sector experienced a substantial rise in defaults as the Irish property market declined, reflecting the difficult economic backdrop and the uncertainty surrounding the possible effect of the Irish Government's National Asset Management Agency on asset values. Sectors driven by consumer spending have been affected by the double digit decline in 2009 with rising default rates evident.

Customer account numbers increased by 3% during 2009, with growth fuelled by strong current account activity and new-to-bank savings customers.

US Retail & Commercial

	2010 US$m	2009 US$m	2008 US$m	2010 £m	2009 £m	2008 £m
Net interest income	2,962	2,777	3,200	1,917	1,775	1,726
Net fees and commissions	1,126	1,119	1,231	729	714	664
Other non-interest income	465	368	362	300	235	197
Non-interest income	1,591	1,487	1,593	1,029	949	861
Total income	4,553	4,264	4,793	2,946	2,724	2,587
Direct expenses						
- staff	(1,212)	(1,214)	(1,194)	(784)	(776)	(645)
- other	(880)	(929)	(654)	(569)	(593)	(354)
Indirect expenses	(1,189)	(1,196)	(1,157)	(770)	(766)	(623)
	(3,281)	(3,339)	(3,005)	(2,123)	(2,135)	(1,622)
Impairment losses	(799)	(1,099)	(811)	(517)	(702)	(437)
Operating profit/(loss)	473	(174)	977	306	(113)	528
Average exchange rate - US$/£				1.546	1.566	1.853
Analysis of income by product						
Mortgages and home equity	786	781	695	509	499	375
Personal lending and cards	735	706	617	476	451	333
Retail deposits	1,397	1,296	1,853	903	828	1,000
Commercial lending	896	848	751	580	542	405
Commercial deposits	495	624	698	320	398	377
Other	244	9	179	158	6	97
Total income	4,553	4,264	4,793	2,946	2,724	2,587
Analysis of impairment by sector						
Residential mortgages	90	113	76	58	72	41
Home equity	194	261	125	126	167	67
Corporate and commercial	312	510	335	202	326	181
Other consumer	150	215	275	97	137	148
Securities	53	—	—	34	—	—
Total impairment losses	799	1,099	811	517	702	437
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Residential mortgages	1.0%	1.1%	0.5%	1.0%	1.1%	0.4%
Home equity	0.8%	1.0%	0.5%	0.8%	1.1%	0.4%
Corporate and commercial	1.0%	1.6%	1.0%	1.0%	1.7%	0.8%
Other consumer	1.4%	1.8%	1.9%	1.4%	1.8%	1.5%
	1.0%	1.4%	0.9%	1.0%	1.4%	0.7%

Performance ratios

Return on equity (1)	3.6%	(1.3%)	7.9%	3.6%	(1.3%)	7.8%
Net interest margin	2.85%	2.37%	2.68%	2.85%	2.37%	2.68%
Cost:income ratio	72%	78%	63%	72%	78%	63%

Note:
(1) Divisional return on equity is based on divisional operating profit/(loss) after tax divided by average notional equity (based on 9% of the monthly average of divisional RWAs, adjusted for capital deductions).

	2010 US$bn	2009 US$bn	2008 US$bn	2010 £bn	2009 £bn	2008 £bn
Capital and balance sheet						
Total third party assets	110.5	122.3	129.5	71.2	75.4	88.7
Loans and advances to customers (gross)						
- residential mortgages	9.4	10.6	13.9	6.1	6.5	9.5
- home equity	23.6	25.0	27.2	15.2	15.4	18.7
- corporate and commercial	31.7	31.6	34.7	20.4	19.5	23.8
- other consumer	10.6	12.1	14.3	6.9	7.5	9.8
	75.3	79.3	90.1	48.6	48.9	61.8
Customer deposits (excluding repos)	91.2	97.4	93.4	58.7	60.1	63.9
Risk elements in lending						
- retail	0.7	0.6	0.3	0.4	0.4	0.2
- commercial	0.7	0.4	0.2	0.5	0.2	0.2
	1.4	1.0	0.5	0.9	0.6	0.4
Loan:deposit ratio (excluding repos)	81%	80%	96%	81%	80%	96%
Risk-weighted assets	88.4	96.9	93.2	57.0	59.7	63.9
Spot exchange rate - US$/£				1.552	1.622	1.460

2010 compared with 2009
Operating profit of £306 million ($473 million) represented a marked improvement from an operating loss of £113 million ($174 million) with income up 8%, expenses down 1% and impairment losses down 26%.

Net interest income was up 7%, despite a smaller balance sheet, with net interest margin improving by 48 basis points to 2.85%.

Non-interest income was up 8% reflecting higher mortgage banking and debit card income, commercial banking fees and higher gains on securities realisations. This was partially offset by lower deposit fees which were impacted by Regulation E legislative changes in 2010. In addition, gains of £213 million ($330 million) were recognised on the sale of available-for-sale securities as part of the balance sheet restructuring exercise, but these were almost wholly offset by losses crystallised on the termination of swaps hedging fixed-rate funding.

Total expenses were down 1%, reflecting a £74 million ($113 million) credit related to changes to the defined benefit pension plan, and lower Federal Deposit Insurance Corporation (FDIC) deposit insurance levies, partially offset by the impact of changing rates on the valuation of mortgage servicing rights and litigation costs.

Impairment losses declined 26%, following significant loan reserve building in 2009 and a gradual improvement in the underlying credit environment, offset by higher impairments related to securities. Loan impairments as a percentage of loans and advances decreased from 1.4% to 1.0%.

2009 compared with 2008
The recessionary economic environment, historically low interest rates and deteriorating credit conditions resulted in an operating loss before tax of £113 million. However, the business has now successfully refocused on its core customer franchises in New England, the Mid-Atlantic region and the Midwest. In dollar terms, an operating loss

before tax of $174 million was recorded.

The division achieved very strong growth in mortgage origination volumes, with significantly higher penetration through the branch network and improved profitability, particularly on recent origination vintages. Cross-selling of card, deposit and checking account products has increased substantially, with over 65% of new mortgage customers also taking out a checking account. The division has also increased commercial banking market penetration, with lead bank share within its footprint increasing, in dollar terms, from 6% to 7% in the $5 million to $25 million segment and from 6% to 8% in the $25 million to $500 million segment.

Net interest income was up 3%, principally as a result of movements in exchange rates. However, net interest margin was down 31bps for the full year, reflecting the decline in deposit margins resulting from the low interest rate environment, though margins have been partially rebuilt in the second half from the lows experienced in the first half, as the business repriced lending rates and aggressively reduced pricing on term and time deposits.

Expenses increased by 32%, reflecting increased FDIC deposit insurance levies, higher employee benefit costs as well as increased costs relating to loan workout and collection activity. In dollar terms, expenses increased by 11%. Successful execution of restructuring activities resulted in approximately $75 million of cost savings.

Impairment losses increased to £702 million ($1,099 million) as charge-offs climbed to 0.90% of loans, an increase of 34bps compared with 2008.

Loans and advances were down 21%, reflecting subdued customer demand.

Customer deposits decreased 6% from the prior year. In dollar terms, customer deposits increased 4% as the deposit mix improved significantly, with strong growth in checking balances combined with migration away from higher priced term and time deposits as the division adjusted its pricing strategies. Over 58,000 consumer checking accounts were added over the course of the year, and more than 13,000 small business checking accounts. Consumer checking balances grew by 8% and small business balances by 12%.

Global Banking & Markets

	2010 £m	2009 £m	2008 £m
Net interest income from banking activities	1,252	2,424	2,390
Funding costs of rental assets	(37)	(49)	(64)
Net interest income	1,215	2,375	2,326
Net fees and commissions receivable	1,283	1,144	973
Income from trading activities	5,432	8,147	(748)
Other operating income	(18)	(608)	(194)
Non-interest income	6,697	8,683	31
Total income	7,912	11,058	2,357
Direct expenses			
- staff	(2,693)	(2,904)	(2,034)
- other	(842)	(777)	(1,017)
Indirect expenses	(862)	(979)	(937)
	(4,397)	(4,660)	(3,988)
Impairment losses	(151)	(640)	(522)
Operating profit/(loss)	3,364	5,758	(2,153)
Analysis of income by product			
Rates - money markets	65	1,714	1,641
Rates - flow	1,985	3,142	1,386
Currencies & commodities	870	1,277	1,539
Credit and mortgage markets	2,215	2,255	(3,435)
Portfolio management and origination	1,844	1,196	858
Equities	933	1,474	368
Total income	7,912	11,058	2,357
Analysis of impairment by sector			
Manufacturing and infrastructure	(51)	91	39
Property and construction	74	49	12
Banks and financial institutions	177	348	186
Other	(49)	152	285
Total impairment losses	151	640	522
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements)	0.2%	0.6%	0.3%
Performance ratios			
Return on equity (1)	16.6%	29.8%	(9.1%)
Net interest margin	1.05%	1.38%	1.34%
Cost:income ratio	56%	42%	169%
Compensation ratio (2)	34%	26%	86%

Notes:

(1) Divisional return on equity is based on divisional operating profit/(loss) after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Compensation ratio is based on staff costs as a percentage of total income, excluding the fair value of own debt.

	2010 £bn	2009 £bn	2008 £bn
Capital and balance sheet			
Loans and advances to customers	75.1	90.9	168.7
Loans and advances to banks	44.5	36.9	55.5
Reverse repos	94.8	73.3	88.8
Securities	119.2	106.0	127.5
Cash and eligible bills	38.8	74.0	20.2
Other	24.3	31.1	38.0
Total third party assets (excluding derivatives mark-to-market)	396.7	412.2	498.7
Net derivative assets (after netting)	37.4	68.0	121.0
Customer deposits (excluding repos)	38.9	46.9	87.8
Risk elements in lending	1.7	1.8	0.9
Loan:deposit ratio (excluding repos)	193%	194%	192%
Risk-weighted assets	146.9	123.7	151.8

2010 compared with 2009
A fall in operating profit of 42% year on year reflects sharply reduced revenue partially offset by lower costs and a significant improvement in impairments.

Total income was £3,146 million lower in 2010 driven by increased risk aversion in the market during Q3 and Q4 2010, combined with the non-repeat of favourable market conditions seen in the first half of 2009.

- Higher revenue across the Rates and Currencies businesses during 2009 was driven by rapidly falling interest rates and wide bid-offer spreads generating exceptional revenue opportunities, which have not been repeated in 2010.

- The Credit Markets business remained broadly flat, supported by strong Mortgage Trading income where customer demand remained buoyant during 2010.

- Increased revenue from Portfolio Management was driven by disciplined lending alongside a reduction in balance sheet management activities and associated costs.

Expenses fell by 6% to £4,397 million. This was largely driven by a decrease in staff costs, including on-going benefits from cost synergies.

The low level of impairments in 2010 reflected a small number of specific cases partially offset by an improved picture on latent loss provisions. This contrasted with 2009, which witnessed a significantly higher level of specific impairments.

At 16.6%, return on equity remained consistent with the 15% targeted over the business cycle in GBM's strategic plan. The compensation ratio of 34% was below that of peers.

2009 compared with 2008
Operating profit improved to £5,758 million in 2009, compared with an operating loss of £2,153 million in 2008. Although the buoyant market conditions experienced in the first quarter levelled off over the course of the year, the

refocusing of the business on its core franchises was successful. GBM has tightened its balance sheet management over the course of the year, with disciplined deployment of capital to support its targeted client base.

In an often volatile market environment, GBM responded quickly to its clients' needs to strengthen their balance sheets and to take advantage of the attractive environment for debt and equity issues. RBS participated in the five largest equity issues worldwide in 2009, and in six out of the ten largest debt capital markets transactions.

Income grew significantly, reflecting a very strong first quarter benefiting from market volatility, client activity and a marked improvement from credit and mortgage markets. Rates flow business, up 127%, benefited from good client activity, while strong equity capital markets drove a fourfold increase in Equities.

Portfolio management and origination grew 39% as financial institutions and corporate clients refinanced through the debt capital markets. The refocused credit and mortgage markets delivered a much improved result from greater liquidity and a more positive trading environment.

Despite quarterly movement in the Group's credit spreads, overall spreads remained broadly flat over the year resulting in a small loss from movements in the fair value of own debt compared with a £357 million gain in 2008.

Expenses increased 17%, reflecting higher performance-related costs and the impact of adverse exchange rate movements, partly offset by restructuring and efficiency benefits. Less than half of the change in staff costs related to increases in 2009 bonus awards.

Global Banking & Markets continued

2009 compared with 2008 continued
Staff costs represented 26% of income. The Group introduced new deferral policies in 2009, which have led to changes in accrual patterns. Adjusting for both 2008 and 2009 deferrals, GBM's compensation ratio in 2009 would have been 28%.

Higher impairments principally reflected a large individual failure recognised in the third quarter. Impairments represented 0.6% of loans and advances to customers compared with 0.3% in the prior year, reflecting the marked reduction in loans and advances.

Total third party assets, excluding derivatives, were down 17%, or 13% at constant exchange rates, compared with 31 December 2008, driven by a 43% reduction in loans and advances as customers took advantage of favourable capital market conditions to raise alternative forms of finance to bank debt. This reduction was partially offset by an increase in liquid assets.

Risk-weighted assets decreased 19%, or 15% at constant exchange rates, reflecting the fall in third party assets and the Group's continued focus on reducing its risk profile and balance sheet usage.

RBS Insurance

	2010 £m	2009 £m	2008 £m
Earned premiums	4,459	4,519	4,512
Reinsurers' share	(148)	(165)	(206)
Net premium income	4,311	4,354	4,306
Fees and commissions	(409)	(366)	(396)
Other income	467	472	520
Total income	4,369	4,460	4,430
Direct expenses:			
- staff	(266)	(267)	(286)
- other	(170)	(222)	(225)
Indirect expenses	(267)	(270)	(261)
	(703)	(759)	(772)
Net claims	(3,961)	(3,635)	(3,032)
Impairment losses	—	(8)	(42)
Operating (loss)/profit	(295)	58	584
Analysis of income by product			
Personal lines motor excluding broker			
- own brands	1,924	1,865	1,799
- partnerships	301	328	369
Personal lines home excluding broker			
- own brands	487	455	434
- partnerships	399	401	421
Personal lines other excluding broker			
- own brands	197	196	193
- partnerships	157	227	202
Other			
- commercial	318	329	294
- international	341	313	367
- other (1)	245	346	351
Total income	4,369	4,460	4,430
In-force policies (000's)			
Personal lines motor excluding broker			
- own brands	4,162	4,762	4,396
- partnerships	645	844	951
Personal lines home excluding broker			
- own brands	1,758	1,717	1,516
- partnerships	1,850	1,918	1,993
Personal lines other excluding broker			
- own brands	2,005	2,319	1,938
- partnerships	8,177	7,335	7,814
Other			

- commercial	284	273	266
- international	1,082	944	949
- other (1)	644	1,123	1,246
Total in-force policies (2)	20,607	21,235	21,069
Gross written premiums (£m)	4,298	4,480	4,384

For notes relating to this table refer to page 46.

RBS Insurance continued

	2010	2009	2008
Performance ratios			
Return on equity (3)	(7.9%)	1.7%	18.3%
Loss ratio (4)	92%	84%	70%
Commission ratio (5)	10%	9%	10%
Expense ratio (6)	13%	14%	14%
Combined operating ratio (7)	115%	106%	94%
Balance sheet			
General insurance reserves - total (£m)	7,559	7,030	6,673

Notes:
(1) Other is predominantly made up of the discontinued personal lines broker business.
(2) Total in-force policies include travel and creditor policies sold through RBS Group. These comprise travel policies included in bank accounts e.g. Royalties Gold Account, and creditor policies sold with bank products including mortgage, loan and card repayment payment protection.
(3) Divisional return on equity is based on divisional operating (loss)/profit after tax, divided by divisional average notional equity (based on regulatory capital).
(4) Loss ratio is based on net claims divided by net premium income for the UK businesses.
(5) Commission ratio is based on fees and commissions divided by gross written premium income for the UK businesses.
(6) Expense ratio is based on expenses (excluding fees and commissions) divided by gross written premium income for the UK businesses.
(7) Combined operating ratio is expenses (including fees and commissions) divided by gross written premium income, added to the loss ratio, for the UK businesses.

2010 compared with 2009

RBS Insurance has embarked on a significant programme of investment designed to achieve a substantial lift in operational and financial performance, ahead of the planned divestment of the business, with a current target date of 2012. This programme encompasses the enhancement of pricing capability, transformation of claims operations and expense reduction, together with a range of other improvements across the business, including a greater focus on capital management.

2010 as a whole was a disappointing profit year, impacted by significant reserve strengthening for bodily injury claims and severe weather, resulting in a loss of £295 million.

Income was down 2% (£91 million) against 2009, driven by a managed reduction in the risk of the UK motor book, largely offset by significant price increases:

- This de-risking was achieved by a combination of rating action to reduce the mix of higher-risk drivers, and the partial or total exit of higher risk business lines (significantly scaling back the fleet and taxi business and the exit of personal lines business sold through insurance brokers). As a result in-force motor policies fell 14% compared with 2009.

- Even with the significant reduction in the risk mix of the book, average motor premiums were up 7% in the year, due to significant price increases. The prices of like-for-like policies have increased by 35-40% over the last year. These increases were in addition to the significant increases achieved in 2009.

Initiatives to grow ancillary income were also implemented during the year resulting in revenues of £46 million in 2010 (£25 million in 2009).
Away from UK motor, overall home gross written premiums grew by 2%. This included the exit from less profitable business in line with overall strategy. Our underlying own brands business continues to grow successfully, with gross written premiums increasing 4%.

The International business continued to invest in growth in 2010 with gross written premiums of £425 million up 20% on 2009. The Italian business successfully grew to a market share approaching 30% of the direct insurer market. The German business grew 7% and is well positioned to take advantage of the emerging shift to direct/internet distribution in that market.

Several programmes to further improve the overall efficiency of the business took effect during the year, including a reduction of six sites and operational process improvements, which will continue to improve efficiency.

Total in-force policies declined by 3%, driven by a fall of 14% in motor policies. This was partly offset by higher travel policies, up 64% with new business from a partnership with Nationwide Building Society commencing in Q4 2010. The personal lines broker segment overall declined by 43%, in line with business strategy.

Underwriting income declined by £63 million, with lower motor premium income, driven by rating action. Increased fees and commissions reflected profit sharing arrangements with UK Retail in relation to insurance distribution to bank customers. Investment income was £28 million lower, reflecting the impact of low interest rates on returns on the investment portfolio as well as lower gains realised on the sale of investments.

Net claims were £326 million higher than in 2009, driven by increases to bodily injury reserves relating to prior years, including allowance for higher claims costs in respect of Periodic Payment Orders due to an increased settlement rate of such claims. Although bodily injury frequency has stabilised, severity has continued to deteriorate. Claims were also impacted by the adverse weather experienced in the first and fourth quarters.

Expenses were down 7%, driven by lower industry levies and marketing costs.

2009 compared with 2008
Operating profit was severely affected by the rising costs of bodily injury claims, declining to £58 million. Significant price increases were implemented in the latter part of the year to mitigate the industry trend of rising claims costs.

Income grew by 1%, with premium income stable but lower reinsurance costs. Investment income was 20% lower, reflecting the impact of low interest rates and returns on the investment portfolio partially offset by gains realised on the sale of equity investments.

In-force policies grew by 1%, driven by the success of own brands, up 12%. Churchill and Privilege have benefited from deployment on selected price comparison websites, with motor policy numbers up 19% and 3% respectively, and home policies up 32% and 109% respectively, compared with prior year. Direct Line motor and home policies grew by 4% and 2% respectively. The partnerships and broker segment declined by 10% in line with business strategy.

Expenses fell by 2% in 2009, with wage inflation, higher industry levies and professional fees offset by cost efficiencies, reduction in headcount and lower marketing expenditure.

Net claims were 20% higher than in 2008 driven by a £448 million increase in bodily injury claims as well as by adverse weather experienced in the fourth quarter. Significant price increases were implemented in the latter part of the year to mitigate the industry trend of rising claims costs, and additional significant initiatives have also been undertaken to adapt pricing models and enhance claims management.

The UK combined operating ratio, including business services costs, was 106% compared with 94% in the previous year, with the impact of the increase in reserves for bodily injury claims and the bad weather experience only partially mitigated by commission and expense ratio improvement.

Central items

	2010 £m	2009 £m	2008 £m
Central items not allocated	577	385	150

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

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

2010 compared with 2009

Central items not allocated including available-for-sale (AFS) gains of £237 million and one-off VAT recovery in 2010 of £170 million, amounted to a net credit of £577 million, an increase of £192 million on 2009.

The Group’s credit spreads have fluctuated over the course of the year, but ended the year slightly wider, resulting in an overall annual decrease in the carrying value of own debt.

2009 compared with 2008

Items not allocated during the year amounted to a net credit of £385 million. The Group's credit spreads have fluctuated over the course of the year, but ended the year slightly tighter, resulting in an increase in the carrying value of own debt. This was offset by a net credit on unallocated Group Treasury items, including the impact of economic hedges that do not qualify for IFRS hedge accounting. 2008 results included some significant disposal gains.

Non-Core

	2010	2009	2008
	£m	£m	£m
Net interest income from banking activities	1,966	1,504	2,028
Funding costs of rental assets	(283)	(256)	(380)
Net interest income	1,683	1,248	1,648
Net fees and commissions	449	472	889
Loss from trading activities	(16)	(5,123)	(7,716)
Insurance net premium income	702	784	986
Other operating income			
- rental income	1,035	976	1,190
- other (1)	(820)	(658)	(29)
Non-interest income	1,350	(3,549)	(4,680)
Total income	3,033	(2,301)	(3,032)
Direct expenses			
- staff	(731)	(851)	(988)
- operating lease depreciation	(452)	(402)	(475)
- other	(642)	(642)	(681)
Indirect expenses	(500)	(552)	(539)
	(2,325)	(2,447)	(2,683)
Insurance net claims	(737)	(588)	(700)
Impairment losses	(5,476)	(9,221)	(4,936)
Operating loss	(5,505)	(14,557)	(11,351)
Analysis of income by business			
Banking & portfolios	550	(1,338)	2,324
International businesses & portfolios	1,922	2,262	2,980
Markets	561	(3,225)	(8,336)
Total income	3,033	(2,301)	(3,032)
Performance ratios			
Net interest margin	1.16%	0.69%	0.87%
Cost:income ratio	77%	(106%)	(88%)
Adjusted cost:income ratio	101%	(85%)	(72%)
	£bn	£bn	£bn
Capital and balance sheet (2,3)			
Total third party assets (excluding derivatives)	137.9	201.0	257.9
Total third party assets (including derivatives)	153.9	220.9	342.9
Loans and advances to customers (gross)	108.4	149.5	191.4
Customer deposits	6.7	12.6	27.4
Risk elements in lending	23.4	22.9	11.1
Risk-weighted assets	153.7	171.3	170.9

Notes:

(1) Includes losses on disposals of £504 million for the year ended 31 December 2010.

(2) Includes disposal groups.
(3) Includes RBS Sempra Commodities JV: 2010 third party assets (TPAs) £6.7 billion; RWAs £4.3 billion (2009 TPAs £14.2 billion; RWAs £10.2 billion).

Non-Core continued

	2010 £m	2009 £m	2008 £m
(Loss)/income from trading activities			
Monoline exposures	(5)	(2,387)	(3,121)
Credit derivative product companies	(139)	(947)	(615)
Asset-backed products (1)	235	(288)	(3,220)
Other credit exotics	77	(558)	(935)
Equities	(17)	(47)	(947)
Leveraged finance	—	—	(1,088)
Banking book hedges	(82)	(1,613)	1,690
Other (2)	(85)	717	520
	(16)	(5,123)	(7,716)
Impairment losses			
Banking & portfolios	1,311	4,215	938
International businesses & portfolios	4,217	4,494	1,832
Markets	(52)	512	2,166
Total impairment losses	5,476	9,221	4,936
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) (3)			
Banking & portfolios	2.2%	4.9%	0.9%
International businesses & portfolios	7.9%	6.6%	2.3%
Markets	0.1%	5.2%	9.4%
	4.9%	5.7%	2.2%
	£bn	£bn	£bn
Gross customer loans and advances			
Banking & portfolios	55.6	82.0	97.0
International businesses & portfolios	52.5	65.6	79.9
Markets	0.3	1.9	14.5
	108.4	149.5	191.4
Risk-weighted assets			
Banking & portfolios	51.2	58.2	63.1
International businesses & portfolios	37.5	43.8	50.1
Markets	65.0	69.3	57.7
	153.7	171.3	170.9

Third party assets (excluding derivatives)	31 December 2009 £bn	Run-off £bn	Disposals/ restructuring £bn	Drawings/ roll overs £bn	Impairments £bn	FX £bn	31 December 2010 £bn

Commercial real estate	51.3	(6.2)	(1.4)	3.2	(4.6)	0.3	42.6
Corporate	82.6	(12.0)	(13.0)	2.0	(0.2)	0.4	59.8
SME	3.9	(0.2)	—	0.1	(0.1)	—	3.7
Retail	19.9	(7.7)	(2.6)	0.1	(0.6)	(0.1)	9.0
Other	4.7	(2.1)	(0.4)	0.3	—	—	2.5
Markets	24.4	(3.0)	(9.8)	1.3	—	0.7	13.6
Total (excluding derivatives)	186.8	(31.2)	(27.2)	7.0	(5.5)	1.3	131.2
Markets - RBS Sempra							
Commodities JV	14.2	(1.7)	(6.3)	—	—	0.5	6.7
Total (4)	201.0	(32.9)	(33.5)	7.0	(5.5)	1.8	137.9

Notes:

(1) Asset-backed products include super senior asset-backed structures and other asset-backed products.

(2) Includes profits in RBS Sempra Commodities JV of £19 million (2009 - £770 million; 2008 - £764 million).

(3) Includes disposal groups.

(4) £12 billion of disposals have been signed as of 31 December 2010 but are pending closing (2009 - £3 billion; 2008 - nil).

Loan impairment losses by donating division and sector	2010 £m	2009 £m	2008 £m
UK Retail			
Mortgages	5	6	1
Personal	8	47	42
Other	—	—	62
Total UK Retail	13	53	105
UK Corporate			
Manufacturing and infrastructure	26	87	42
Property and construction	437	651	281
Transport	3	10	(3)
Banks and financials	69	102	4
Lombard	129	95	61
Invoice finance	(3)	3	—
Other	169	729	142
Total UK Corporate	830	1,677	527
Ulster Bank			
Mortgages	42	42	6
Commercial investment and development	699	303	9
Residential investment and development	1,690	716	229
Other	251	217	60
Other EMEA	52	106	116
Total Ulster Bank	2,734	1,384	420
US Retail & Commercial			
Auto and consumer	82	136	140
Cards	23	130	63
SBO/home equity	277	452	321
Residential mortgages	4	54	6
Commercial real estate	185	224	54
Commercial and other	17	83	20
Total US Retail & Commercial	588	1,079	604
Global Banking & Markets			
Manufacturing and infrastructure	(290)	1,404	1,280
Property and construction	1,296	1,413	710
Transport	33	178	12
Telecoms, media & technology	9	545	55
Banks and financials	196	620	870
Other	14	567	177
Total Global Banking & Markets	1,258	4,727	3,104
Other			
Wealth	51	251	174

Global Transaction Services	—	49	(2)
Central items	2	1	4
Total Other	53	301	176
Total impairment losses	5,476	9,221	4,936

Non-Core continued

Gross loans and advances to customers (excluding reverse repurchase agreements) by donating division and sector	2010 £bn	2009 £bn	2008 £bn
UK Retail			
Mortgages	1.6	1.9	2.2
Personal	0.4	0.7	1.1
Total UK Retail	2.0	2.6	3.3
UK Corporate			
Manufacturing and infrastructure	0.3	0.3	0.3
Property and construction	11.4	14.1	11.3
Lombard	1.7	2.9	3.7
Invoice finance	—	0.4	0.7
Other	13.6	17.2	22.1
Total UK Corporate	27.0	34.9	38.1
Ulster Bank			
Mortgages	—	6.0	6.5
Commercial investment and development	5.6	3.0	2.9
Residential investment and development	7.1	5.6	5.9
Other	1.9	1.1	1.1
Other EMEA	0.4	1.0	1.3
Total Ulster Bank	15.0	16.7	17.7
US Retail & Commercial			
Auto and consumer	2.6	3.2	4.2
Cards	0.1	0.5	0.7
SBO/home equity	3.2	3.7	5.2
Residential mortgages	0.7	0.8	1.1
Commercial real estate	1.5	1.9	3.0
Commercial and other	0.5	0.9	1.4
Total US Retail & Commercial	8.6	11.0	15.6
Global Banking & Markets			
Manufacturing and infrastructure	8.7	17.5	
Property and construction	19.6	25.7	
Transport	5.5	5.8	
Telecoms, media and technology	0.9	3.2	
Banks and financials	12.0	16.0	
Other	9.0	13.5	
Total Global Banking & Markets	55.7	81.7	104.8
Other			
Wealth	0.4	2.6	3.6
Global Transaction Services	0.3	0.8	1.4

RBS Insurance	0.2	0.2	0.2
Central items	(1.0)	(3.2)	—
Total Other	(0.1)	0.4	5.2
Gross loans and advances to customers (excluding reverse repurchase agreements)	108.2	147.3	184.7

52

2010 compared with 2009
By the end of 2010 third party assets (excluding derivatives) had decreased to £138 billion, £5 billion lower than the end of year target, as a result of a successful disposal strategy, managed portfolio run-off and impairments.

2010 operating losses in Non-Core were 62% lower than those recorded in 2009. The improvement in performance was driven by significantly lower trading losses, reduced expenses and a marked decline in impairments.

Losses from trading activities declined from £5,123 million for 2009 to £16 million for 2010 as underlying asset prices recovered, offset by continuing weakness in credit spreads. The division has recorded profits on the disposal of many asset-backed securities positions. In addition, a significantly smaller loss of £161 million was recorded on banking book hedges as spreads tightened, compared with £1,728 million in 2009.

Staff expenses fell by 14% over the year, largely driven by the impact of business divestments, including a number of country exits and the disposal of substantially all of the Group’s interest in the RBS Sempra Commodities JV.

Impairments were £3,745 million lower than 2009. The decline reflects the overall improvement in the economic environment, although still high loss rates reflect the difficult conditions experienced in specific sectors, including both UK and Irish commercial property sectors.

Wholesale country exits completed during 2010 were Chile, Colombia, Pakistan and Taiwan.

Risk-weighted assets decreased by £18 billion (10%), reflecting active management to reduce trading book risk and disposals, partially offset by the impact of regulatory changes (£30 billion) and more conservative weightings applied to large corporate exposures.

2009 compared with 2008
Losses from trading activities have declined significantly as underlying asset prices rallied. Mark-to-market values for exposures such as monolines, super senior high grade collateralised debt obligations, and many negative basis trade asset classes have risen over the course of 2009. However, the £1.6 billion gain recorded on banking book hedging in 2008 unwound over the course of the year to a loss of £1.6 billion in 2009, as spreads continued to tighten throughout the year, ending almost in line with origination levels.

Impairment losses increased to £9.2 billion, reflecting continued weakness in the economic environment, particularly across the corporate and property sectors. There were signs of a slowdown in the rate of provisioning towards the end of the year.

Staff costs decreased by 14% over the year, or by 20% at constant exchange rates, due to headcount reductions and business divestments, notably Linea Directa and Tesco Personal Finance. Lower depreciation charges followed the 2008 sale of the Angel Trains business.

Third party assets, excluding derivatives, decreased by £56.9 billion in the year as the division has run down exposures and pursued opportunities to dispose of loan portfolios. Sales of equity stakes, including Bank of China, were concluded while further disposals announced in 2009, including Asian retail and commercial operations, are moving towards completion in 2010.

Risk-weighted assets increased by 0.2% in 2009, and at constant exchange rates increased by 3%. The reduction of 15% since 30 September 2009, reflects active management to reduce trading book exposures, largely offset by the impact of procyclicality, monoline downgrades and adverse market risk.

Consolidated balance sheet at 31 December 2010

	2010 £m	2009 £m	2008 £m
Assets			
Cash and balances at central banks	57,014	52,261	12,400
Net loans and advances to banks	57,911	56,656	79,426
Reverse repurchase agreements and stock borrowing	42,607	35,097	58,771
Loans and advances to banks	100,518	91,753	138,197
Net loans and advances to customers	502,748	687,353	835,409
Reverse repurchase agreements and stock borrowing	52,512	41,040	39,313
Loans and advances to customers	555,260	728,393	874,722
Debt securities	217,480	267,254	267,549
Equity shares	22,198	19,528	26,330
Settlement balances	11,605	12,033	17,832
Derivatives	427,077	441,454	992,559
Intangible assets	14,448	17,847	20,049
Property, plant and equipment	16,543	19,397	18,949
Deferred tax	6,373	7,039	7,082
Prepayments, accrued income and other assets	12,576	20,985	24,402
Assets of disposal groups	12,484	18,542	1,581
Total assets	1,453,576	1,696,486	2,401,652
Liabilities			
Bank deposits	66,051	104,138	174,378
Repurchase agreements and stock lending	32,739	38,006	83,666
Deposits by banks	98,790	142,144	258,044
Customers deposits	428,599	545,849	581,369
Repurchase agreements and stock lending	82,094	68,353	58,143
Customer accounts	510,693	614,202	639,512
Debt securities in issue	218,372	267,568	300,289
Settlement balances	10,991	10,413	11,741
Short positions	43,118	40,463	42,536
Derivatives	423,967	424,141	971,364
Accruals, deferred income and other liabilities	23,089	30,327	31,482
Retirement benefit liabilities	2,288	2,963	2,032
Deferred tax	2,142	2,811	4,165
Insurance liabilities	6,794	10,281	9,976
Subordinated liabilities	27,053	37,652	49,154
Liabilities of disposal groups	9,428	18,890	859
Total liabilities	1,376,725	1,601,855	2,321,154
Non-controlling interests	1,719	16,895	21,619
Owners' equity	75,132	77,736	58,879
Total equity	76,851	94,631	80,498
Total liabilities and equity	1,453,576	1,696,486	2,401,652

Commentary on consolidated balance sheet

2010 compared with 2009

Total assets of £1,453.6 billion at 31 December 2010 were down £242.9 billion, 14%, compared with 31 December 2009. This principally reflects the disposal of the RFS minority interest, the continuing planned disposal of Non-Core assets, together with a reduction in the level of debt securities and the mark-to-market value of derivatives.

Cash and balances at central banks were up £4.8 billion, 9%, to £57.0 billion principally due to an improvement in the Group's structural liquidity position during 2010.

Loans and advances to banks increased by £8.8 billion, 10%, to £100.5 billion. Adjusting for the disposal of the RFS minority interest, the increase was £16.6 billion, 20%. Reverse repurchase agreements and stock borrowing ('reverse repos') were up £7.5 billion, 21% to £42.6 billion and bank placings rose £9.1 billion, 19%, to £57.9 billion, primarily as a result of the investment of surplus liquidity in short-term assets.

Loans and advances to customers decreased £173.1 billion, 24%, to £555.3 billion. Excluding the disposal of the RFS minority interest, lending to customers was down £40.4 billion, 7%. Within this, reverse repurchase agreements were up £11.5 billion, 28%, to £52.5 billion. Customer lending decreased by £51.9 billion to £502.7 billion or £48.9 billion before impairment provisions. This reflected planned reductions in Non-Core of £39.7 billion along with declines in Global Banking & Markets, £16.7 billion, US Retail & Commercial, £2.6 billion and Ulster Bank, £2.0 billion. These were partially offset by growth in UK Retail, £5.4 billion, Wealth, £2.4 billion and Global Transaction Services, £1.7 billion, together with the effect of exchange rate and other movements, £2.6 billion.

Debt securities were down £49.8 billion, 19%, to £217.5 billion, or £31.6 billion, 13%, adjusting for the disposal of the RFS minority interest, driven mainly by reductions in Global Banking & Markets.

The value of derivative assets were down £14.4 billion, 3%, to £427.1 billion, primarily reflecting a decrease in interest contracts, movements in five to ten year interest yields, and the combined effect of currency movements, with Sterling weakening against the dollar but strengthening against the Euro.

The reduction in assets and liabilities of disposal groups resulted from the completion of disposals of certain of the Group's Asian and Latin American businesses, and substantially all of the RBS Sempra Commodities JV business.

Deposits by banks declined £43.4 billion, 31%, to £98.8 billion or £55.0 billion, 36% following the disposal of the RFS minority interest, with reduced inter-bank deposits, down £49.7 billion, 43%, to £65.9 billion and lower repurchase agreements and stock lending ('repos'), down £5.3 billion, 14%, to £32.7 billion.

Customer accounts decreased £103.5 billion, 17%, to £510.7 billion but were up £28.1 billion, 6%, excluding the disposal of the RFS minority interest. Within this, repos increased £13.7 billion, 20%, to £82.1 billion. Excluding repos, customer deposits were up £14.3 billion, 3%, to £428.6 billion, reflecting growth in UK Corporate, £12.2 billion, Global Transaction Services, £7.8 billion, UK Retail, £7.0 billion, Ulster Bank, £1.7 billion and Wealth, £0.8 billion, together with exchange rate and other movements of £3.0 billion. This was partially offset by decreases in Global Banking & Markets, £8.3 billion, US Retail & Commercial, £4.0 billion and Non-Core, £5.9 billion.

Debt securities in issue were down £49.2 billion, 18%, to £218.4 billion. Excluding the RFS minority interest disposal, they declined £28.0 billion, 11%, to £218.4 billion. Reductions in the level of certificates of deposit and commercial paper in Global Banking & Markets were partially offset by a programme of new term issuances totalling £38.4 billion.

Subordinated liabilities decreased by £10.6 billion, 28% to £27.1 billion or £4.5 billion, 14% excluding the disposal of the RFS minority interest. This reflected the redemption of £2.6 billion undated loan capital, debt preference shares and trust preferred securities under the liability management exercise completed in May, together with the conversion of £0.8 billion US dollar and Sterling preference shares and the redemption of £1.6 billion of other dated and undated loan capital, which were partially offset by the effect of exchange rate movements and other adjustments of £0.5 billion.

The Group's non-controlling interests decreased by £15.2 billion, primarily reflecting the disposal of the RFS minority interest, £14.4 billion, the majority of the RBS Sempra Commodities JV business, £0.6 billion, and the life assurance business, £0.2 billion.

Owner's equity decreased by £2.6 billion, 3%, to £75.1 billion. This was driven by the partial redemption of preference shares and paid-in equity, £3.1 billion less related gains of £0.6 billion, the attributable loss for the period, £1.1 billion, together with an increase in own shares held of £0.7 billion and higher losses in available-for-sale reserves, £0.3 billion. Offsetting these reductions were the issue of £0.8 billion ordinary shares on conversion of US dollar and Sterling non-cumulative preference shares classified as debt and exchange rate and other movements, £1.2 billion.

Commentary on consolidated balance sheet

2009 compared with 2008
Total assets of £1,696.5 billion at 31 December 2009 were down £705.2 billion, 29%, compared with 31 December 2008, principally reflecting substantial repayments of customer loans and advances as corporate customer demand fell and corporates looked to deleverage their balance sheets. Lending to banks also fell in line with significantly reduced wholesale funding activity. There were also significant falls in the value of derivative assets, with a corresponding fall in derivative liabilities.

Cash and balances at central banks were up £39.9 billion to £52.3 billion due to the placing of short-term cash surpluses, including the proceeds from the issue of B shares in December, with central banks.

Loans and advances to banks decreased by £46.4 billion, 34%, to £91.8 billion with reverse repurchase agreements and stock borrowing (‘reverse repos’) down by £23.7 billion, 40% to £35.1 billion and lower bank placings, down £22.7 billion, 29%, to £56.7 billion largely as a result of reduced wholesale funding activity in Global Banking & Markets.

Loans and advances to customers were down £146.3 billion, 17%, at £728.4 billion. Within this, reverse repos increased by 4%, £1.7 billion to £41.0 billion. Excluding reverse repos, lending decreased by £148.0 billion, 18%, to £687.4 billion or by £141.8 billion, 17%, before impairment provisions. This reflected reductions in Global Banking & Markets of £71.4 billion, and planned reductions in Non-Core of £30.1 billion, including a £3.2 billion transfer to disposal groups in respect of RBS Sempra Commodities JV and the Asian and Latin American businesses. Reductions were also experienced in US Retail & Commercial, £7.4 billion; UK Corporate, £5.4 billion; Ulster Bank, £1.8 billion; and the effect of exchange rate movements, £33.1 billion, following the strengthening of sterling during the year, partially offset by growth in UK Retail of £9.2 billion, and in Wealth of £1.4 billion.

Debt securities were flat at £267.3 billion and equity shares decreased by £6.8 billion, 26%, to £19.5 billion, principally due to the sale of the Bank of China investment and lower holdings in Global Banking & Markets and Non-Core, largely offset by growth in Group Treasury, in part reflecting an £18.0 billion increase in the gilt liquidity portfolio, and in the RFS Holdings minority interest.

Settlement balances were down £5.8 billion, 33%, at £12.0 billion as a result of lower customer activity.

Movements in the value of derivative assets, down £551.1 billion, 56%, to £441.5 billion, and liabilities, down £547.2 billion, 56%, to £424.1 billion, reflect the easing of market volatility, the strengthening of sterling and significant tightening in credit spreads in the continuing low interest rate environment.

Increases in assets and liabilities of disposal groups reflect the inclusion of the RBS Sempra Commodities JV business and the planned sale of a number of the Group's retail and commercial activities in Asia and Latin America.

Deposits by banks declined by £115.9 billion, 45%, to £142.1 billion due to a decrease in repurchase agreements and stock lending (‘repos’), down £45.7 billion, 55%, to £38.0 billion and reduced inter-bank deposits, down £70.2 billion, 40% to £104.1 billion principally in Global Banking & Markets, reflecting reduced reliance on wholesale funding, and in the RFS Holdings minority interest.

Customer accounts were down £25.3 billion, 4%, to £614.2 billion. Within this, repos increased £10.2 billion, 18%, to £68.4 billion. Excluding repos, deposits were down £35.5 billion, 6%, to £545.8 billion, primarily due to; reductions in Global Banking & Markets, down £43.6 billion; Non-Core, £13.0 billion; including the transfer of £8.9 billion to disposal groups; and Ulster Bank, £1.2 billion; together with exchange rate movements, £21.3 billion, offset in part by growth across all other divisions, up £23.0 billion, and in the RFS Holdings minority interest, up £20.6 billion.

Debt securities in issue were down £32.7 billion, 11% to £267.6 billion mainly as a result of movements in exchange rates, together with reductions in Global Banking & Markets, Non-Core and the RFS Holdings minority interest.

Retirement benefit liabilities increased by £0.9 billion, 46%, to £3.0 billion, with net actuarial losses of £3.7 billion, arising from lower discount rates and higher assumed inflation, partially offset by curtailment gains of £2.1 billion due to changes in prospective pension benefits.

Subordinated liabilities were down £11.5 billion, 23% to £37.7 billion, reflecting the redemption of £5.0 billion undated loan capital, £1.5 billion trust preferred securities and £2.7 billion dated loan capital, together with the effect of exchange rate movements and other adjustments, £2.9 billion, partly offset by the issue of £2.3 billion undated loan capital within the RFS Holdings minority interest.

Equity non-controlling interests decreased by £4.7 billion, 22%, to £16.9 billion. Equity withdrawals of £3.1 billion, due to the disposal of the investment in the Bank of China attributable to minority shareholders and the redemption, in part, of certain trust preferred securities, exchange rate movements of £1.4 billion, the recycling of related available-for-sale reserves to income, £0.5 billion, and dividends paid of £0.3 billion, were partially offset by attributable profits of £0.3 billion.

Owners' equity increased by £18.9 billion, 32% to £77.7 billion. The issue of B shares to HM Treasury in December 2009 raised £25.1 billion, net of expenses, and was offset in part by the creation of a £1.2 billion reserve in respect of contingent capital B shares. The placing and open offer in April 2009 raised £5.3 billion to fund the redemption of the £5.0 billion preference shares issued to HM Treasury in December 2008. Actuarial losses, net of tax, of £2.7 billion; the attributable loss for the period, £2.7 billion; exchange rate movements of £1.9 billion; the payment of other owners dividends of £0.9 billion including £0.3 billion to HM Treasury on the redemption of preference shares, and partial redemption of paid-in equity £0.3 billion were partly offset by increases in available-for-sale reserves, £1.8 billion; cash flow hedging reserves, £0.6 billion; and the equity owners gain on withdrawal of non-controlling interests, net of tax, of £0.5 billion arising from the redemption of trust preferred securities.

Cash flow

	2010 £m	2009 £m	2008 £m
Net cash flows from operating activities	19,291	(992)	(75,338)
Net cash flows from investing activities	3,351	54	16,997
Net cash flows from financing activities	(14,380)	18,791	15,102
Effects of exchange rate changes on cash and cash equivalents	82	(8,592)	29,209
Net increase/(decrease) in cash and cash equivalents	8,344	9,261	(14,030)

2010

The major factors contributing to the net cash inflow from operating activities of £19,291 million were the increase of £17,095 million in operating assets less operating liabilities, depreciation and amortisation of £2,220 million and income taxes received of £565 million, partly offset by the net operating loss before tax of £940 million from continuing and discontinued operations.

Net cash flows from investing activities of £3,351 million relate to the net inflows from sales of securities of £4,119 million and investments in business interests and intangibles of £3,446 million. This was partially offset by the outflow of £4,112 million from investing activities of discontinued operations.

Net cash outflow from financing activities of £14,380 million primarily arose from the redemption of non-controlling interests of £5,282 million, dividends paid of £4,240 million, repayment of subordinated liabilities of £1,588 million and the redemption of preference shares of £2,359 million.

2009

The major factors contributing to the net cash outflow from operating activities of £992 million were the net operating loss before tax of £2,696 million from continuing and discontinued operations, the decrease of £15,964 million in operating liabilities less operating assets, partly offset by the elimination of foreign exchange differences of £12,217 million and other items of £5,451 million.

Net cash flows from investing activities of £54 million relate to the net sales and maturities of securities of £2,899 million and a net cash inflow of £105 million in respect of other acquisitions and disposals less the net cash outflow on disposals of property, plant and equipment of £2,950 million.

Net cash flows from financing activities of £18,791 million primarily arose from the capital raised from the issue of B shares of £25,101 million, the placing and open offer of £5,274 million and the issue of subordinated liabilities of £2,309 million. This was offset in part by the cash outflow on repayment of subordinated liabilities of £5,145 million, redemption of preference shares of £5,000 million, interest paid on subordinated liabilities of £1,746 million and dividends paid of £1,248 million.

2008

The major factors contributing to the net cash outflow from operating activities of £75,338 million were the net operating loss before tax of £36,628 million from continuing and discontinued operations, the decrease of £42,219 million in operating liabilities less operating assets, and the elimination of foreign exchange differences of £41,874 million, partly offset by the write down of goodwill and other intangible assets, £32,581 million and other non-cash items, £8,772 million.

Proceeds on disposal of discontinued activities of £20,113 million was the largest element giving rise to net cash flows of investing activities of £16,997 million. Outflow from net purchases of securities of £1,839 million and net disposals of property, plant and equipment, £3,529 million less the net cash inflow of £2,252 million in respect of other acquisitions and disposals represented the other principal factors.

Net cash flows from financing activities of £15,102 million primarily arose from the capital raised from the placing and open offer of £19,741 million and the rights issue of £12,000 million, the issue of subordinated liabilities of £2,413 million and proceeds of non-controlling interests, £1,427 million. This was offset in part by the cash outflow on redemption of non-controlling interests of £13,579 million, repayment of subordinated liabilities of £1,727 million, dividends paid of £3,193 million and interest paid on subordinated liabilities of £1,967 million.

Capital resources

The following table analyses the Group's regulatory capital resources on a fully consolidated basis at 31 December as monitored by the FSA for regulatory purposes.

	2010	2009	2008	2007	2006
	£m	£m	£m	£m	£m
Capital base					
Tier 1 capital	60,124	76,421	69,847	44,364	30,041
Tier 2 capital	9,897	15,389	32,223	33,693	27,491
Tier 3 capital	—	—	260	200	—
	70,021	91,810	102,330	78,257	57,532
Less: Supervisory deductions	(4,732)	(4,565)	(4,155)	(10,283)	(10,583)
Total regulatory capital	65,289	87,245	98,175	67,974	46,949
Risk-weighted assets (1)					
Credit risk	385,900	513,200	551,300		
Counterparty risk	68,100	56,500	61,100		
Market risk	80,000	65,000	46,500		
Operational risk	37,100	33,900	36,900		
	571,100	668,600	695,800		
Asset Protection Scheme relief	(105,600)	(127,600)	n/a		
	465,500	541,000	695,800		
Banking book:					
On-balance sheet				480,200	318,600
Off-balance sheet				84,600	59,400
Trading book				44,200	22,300
				609,000	400,300
Risk asset ratios	%	%	%	%	%
Core Tier 1	10.7	11.0	6.6	4.5	n/a
Tier 1	12.9	14.1	10.0	7.3	7.5
Total	14.0	16.1	14.1	11.2	11.7

Note:

(1) The data for 2010, 2009 and 2008 are on a Basel II basis; prior periods are on a Basel I basis.

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the Financial Services Authority (FSA). The FSA uses Risk Asset Ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. At 31 December 2010, the Group's total RAR was 14.0% (2009 - 16.1%) and the Tier 1 RAR was 12.9% (2009 - 14.1%).

Risk and balance sheet management

In this section (pages 59 to 164) of the Business review certain information has been audited and is part of the Group's financial statements as permitted by IFRS 7. Other disclosures are unaudited and labelled with an asterisk (*). Key points within this section relate to the Group before RFS Holdings minority interest (RFS MI) for 2009 and 2008 data.

Introduction*

All the disclosures in this section (pages 59 to 65) are unaudited as indicated by an asterisk (*). Risk Management has an integral role to play in the delivery of the strategic plan through the creation and management of appropriate frameworks as illustrated below:

With the need for financial strength and resilience at the heart of this and in order to support the Group's stated objective of standalone strength by 2013, the Group Board agreed in 2009 the key strategic risk objectives which are aligned to all other elements of the plan. These are:

- maintain capital adequacy;
- maintain market confidence;
- deliver stable earnings growth; and
- stable and efficient access to funding and liquidity.

These strategic risk objectives are the bridge between the Group level business strategy and the frameworks, measures and metrics which are used to set appetite and manage risk in the business divisions. The risk appetite framework is aligned with business objectives, with underlying and cascading frameworks and limits, which are described in this section. Enhancements have been made through the year and are ongoing.

Risk appetite

Risk appetite is an expression of the level of risk that the Group is prepared to accept to deliver its business objectives. Risk and balance sheet management across the Group is based on the risk appetite approved by the Board, who will agree targets for each division and regularly review and monitor the Group's performance in relation to risk.

Risk appetite is defined in both quantitative and qualitative terms and serves as a way of tracking risk management performance in implementing the agreed strategy.

- quantitative: encompassing scenario stress testing, risk concentrations, VaR, liquidity and credit related metrics, operational, business risk and regulatory measures.

- qualitative: ensuring that the Group applies the correct principles, policies and procedures, manages reputational risk and develops risk control and culture.

A key part of the Group's risk appetite is the macro reshaping of the balance sheet through the downsizing of Non-Core. The Group will manage down previous concentrations in line with the strategic objectives for 2013. This will be discharged by Non-Core but with Risk Management playing an integral role in executing the plan. Non-Core assets and their movements are shown separately in the pages which follow.

* unaudited

Introduction* continued

Governance

Risk and balance sheet management strategies are owned and set by the 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, as set out below. Representation by, and interaction between, the individual risk disciplines is a key feature of the governance structure, with the aim of promoting cross-risk linkages. The roles and responsibilities fulfilled by the key risk committees have been reviewed and more clearly defined during the course of 2010.

* unaudited

Introduction* continued

Governance continued

The role and remit of these committees is set out below. These committees are supported at a divisional level by a risk governance structure embedded in the businesses. During 2010, Risk Management has been enhanced by the appointment of a Deputy Chief Risk Officer to whom the Divisional CROs and the functional risk heads now report.

Committee	Focus	Membership
Group Board	The Group Board is the main decision making forum at Group level. It ensures that the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations.	The Board of directors
Executive Committee (ExCo)	This committee is responsible for managing Group-wide issues and those operational issues material to the broader Group.	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers: US Retail & Commercial and Head of Americas; RBS Insurance; Global Banking & Markets; UK Corporate; and UK Retail, Wealth and Ulster Head of Restructuring and Risk
Board Risk Committee (BRC)	The Board Risk Committee provides oversight and advice to the Group Board in relation to current and potential future risk exposures of the Group and risk strategy, including determination of risk appetite and tolerance. It reviews the performance of the Group relative to risk appetite and provides oversight of the effectiveness of key Group policies, referred to as the Group Policy Framework.	At least three independent non-executive directors, one of whom is the chairman of the Group Audit Committee
Group Audit Committee (GAC)	The Group Audit Committee is responsible for assisting the Group Board in carrying out its responsibilities relating to accounting policies, internal control and financial reporting functions. It assists on such other matters as may be referred to it by the Group Board and acts as the Audit Committee of the Group Board. The Group Audit Committee also identifies any matters within its remit which it considers that action or improvement is needed and makes recommendations as to the steps to be taken.	At least three independent non-executive directors, at least one of whom is a financial expert as defined in the SEC Rules under the US Exchange Act

Group Remuneration Committee	The Remuneration Committee is responsible for the overview of the Group's remuneration policy and remuneration governance framework, ensuring that remuneration arrangements are consistent with and promote effective risk management. The committee also makes recommendations to the Board on the remuneration arrangements for executive directors.	At least three independent non-executive directors
Executive Credit Group (ECG)	The ECG decides on requests for the extension of existing or new credit limits on behalf of the Board of directors where the proposed aggregate facility limits are in excess of the credit approval authorities granted to individuals in divisions or in RBS Risk Management, or where an appeal against the decline decision of the Group Chief Credit Officer (or delegates) or Group Chief Risk Officer is referred for final decision.	Group A members Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer/Chief Credit Officer RBS N.V. Head of Global Restructuring Group Chief Risk Officer, Non-Core division/APS (alternate) Group B members Group Chief Executive Chief Executive Officers: UK Retail, Wealth and Ulster; US Retail & Commercial and Head of Americas; Global Banking & Markets; RBS Insurance; UK Corporate President, Global Banking & Markets Group Finance Director

* unaudited

Introduction* continued
Governance continued

Committee	Focus	Membership
Executive Risk Forum (ERF)	Acts on all strategic risk and control matters across the 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 Chief Executive Head of Restructuring and Risk Deputy Group Chief Risk Officer Group Finance Director Chief Executive from each division
Group Asset and Liability Committee (GALCO)	Identifies, manages and controls Group balance sheet risks.	Group Finance Director Director, Group Finance Head of Restructuring and Risk Chief Executive Officer from each division Group Chief Accountant Group Treasurer Group Head of Capital Management Global Head of Balance Sheet Management, Group Treasury Global Head of Markets Head of Non-Core division
Group Risk Committee (GRC)	Recommends and approves limits, policies, processes and procedures to enable the effective management of risk across the Group.	Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer Global Head of: Market and Insurance Risk; Operational Risk; Country Risk and Firm Wide Risk Director, Group Finance Chief Operating Officer, RBS Risk Management Director Group Compliance Director Group Regulatory Affairs Divisional Chief Executive Officers' nominees Chief Administrative Officer's nominee for Business Services Divisional Chief Risk Officers Chief Operating Officer Global Restructuring Group

These committees play a key role in ensuring that the Group's risk appetite is supported by effective risk management through limit approval and setting, monitoring and maintenance, reporting and escalation.

The Board Risk Committee considers and recommends for approval by the Group Board, the Group's risk appetite framework and tolerance for current and future strategy, taking into account the Group's capital adequacy and the external risk environment.

The Executive Risk Forum is responsible for ensuring that the implementation of strategy and operations are in line with the risk appetite determined by the Board with a particular focus on identifying and debating macro risks that could, if not managed effectively, impact adherence to the Group’s strategic plan. This is reinforced through policy and limit frameworks ensuring that all staff within the Group make appropriate risk and reward trade-offs within pre-agreed boundaries.

The annual business planning and performance management processes and associated activities together ensure that the expression of risk appetite remains appropriate. Both GRC and GALCO support this work.

* unaudited

Introduction* continued

Risk coverage

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

Risk type	Definition	Features	Key developments in 2010	Risk mitigation
Funding and liquidity risk	The risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost.	Potential to disrupt the business model and stop normal functions of the Group. Potential to fail to meet the supervisory requirements of regulators. Significantly correlates with credit risk losses.	Against a backdrop of further market instability, progress was made in meeting the Group's strategic objectives: reduced reliance on short-term wholesale funding; expanded customer deposit franchise; and increased maturity of term debt issuance.	The Group strengthened the structural integrity of the balance sheet through active management of both asset and liability portfolios including a centrally-managed liquidity portfolio of £155 billion.
Credit risk (including counterparty, country and political risks)	The risk that the Group will incur losses owing to the failure of customers to meet their financial obligations to the Group.	Loss characteristics vary materially across portfolios. Significant correlation between losses and the macroeconomic environment. Concentration risk - potential for large material losses.	Asset quality has broadly stabilised, resulting in total loan impairments 33% lower than in 2009. However, weakness in the Irish economy and falling property values have resulted in the doubling of Ulster Bank Group impairments (Core and Non-Core) in 2010.	Further enhancements were made to the Group's credit risk frameworks as well as the systems and tools that support credit risk management processes. The Group continues to reduce the risk associated with legacy exposures through further reductions in Non-Core assets.
Market risk	The risk that the value of an asset or liability may change as a result of a change in market factors.	Potential for large material losses. Potential for losses due to stress events.	Markets have remained both volatile and uncertain since 2007 resulting in a higher level of market risk, despite a reduction in trading book exposure.	The Group has continued to enhance its market risk management framework and reduced trading and banking book exposures, with asset sales and write-downs within Non-Core and banking book available-for-sale assets in

				Core.
Insurance risk	The risk of financial loss through fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations at the time of underwriting.	Frequent small losses which are material in aggregate. Infrequent large material losses.	There have been significant losses as a result of bodily injury claims across the UK motor insurance industry, including RBS Insurance.	In response to this, the industry has increased pricing on motor insurance business and the Group has made significant progress in removing higher-risk business through targeted rating actions.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent material losses.	The level of operational risk remains high due to the scale of structural change occurring across the Group; increased government and regulatory scrutiny; and external threats (e.g. e-crime).	The Group Policy Framework (GPF) supports the risk appetite setting process and underpins the control environment. The three lines of defence model gives assurance that the standards in GPF are being adhered to.

* unaudited

Introduction* continued
Risk coverage continued

Risk type	Definition	Features	Key developments in 2010	Risk mitigation
Regulatory risk	The risks arising from regulatory changes and enforcement.	Adverse impacts on business/operating models, including increased complexity. Financial costs adapting to changes or from penalties. Reputational damage from enforcement action.	The scale and scope of regulatory change remains at unprecedented levels, particularly in the area of prudential regulation (capital, liquidity, governance and risk management). Increased attention was paid to the treatment of systemically important areas such as recovery and resolution plans, remuneration and capital.	The Group manages regulatory change through active engagement with the FSA, other regulators and governments. The most material risks from new regulations, or changes to existing legislation, are assigned an executive sponsor.
Compliance risk	Risks arising from non-compliance with laws, rules, regulations or other standards applicable to the Group.	Breach or alleged breach could result in public or private censure or fine, could have an adverse impact on the Group's business model (including applicable authorisations and licenses), reputation, results of operations and/or financial condition.	The Group, other global financial institutions and the banking industry have faced increased legal, regulatory and public scrutiny. The Group has continued to engage in discussions with relevant stakeholders, regulators and other governmental and non-governmental bodies, including those in the UK and US, regarding the Group's efforts to satisfy all relevant	The Group has continued to review and enhance its regulatory policies, procedures and operations. During 2010, there has been specific, targeted focus on enhancing arrangements for handling customer complaints and managing the risks associated with money laundering, and sanctions and terrorism financing.

			standards and ensure compliance with applicable existing and prospective laws, rules and regulations.	
Reputational risk	The risks arising from the failure to meet stakeholders' perceptions and expectations.	Failure of the business to provide an experience which meets customers, regulators and other stakeholders' expectations.	Government support brings heightened public scrutiny of the way the Group manages its business including: staff remuneration; how customers are managed; and the levels of lending in the UK and environmental impact.	In 2010, the Group established the Group Corporate Sustainability Committee, and also developed a framework for managing environmental, social and ethical risks to support its lending decisions. Businesses consider potential reputational risks and appropriate mitigants.
Pension risk	The risk that the Group may have to make additional contributions to its defined benefit pension schemes.	Volatile funding position caused by the uncertainty of future investment returns and the projected value of schemes' liabilities.	The triennial funding valuation for the Main scheme was undertaken in 2010 with a schedule of contributions to be agreed with the Trustees.	During 2010, the Group implemented an enhanced reporting and modelling framework to improve the identification and management of key pension risks. In early 2010 the Main scheme increased its bond allocation to better match liabilities.

Each of these risk types map into our risk appetite framework and contribute to the overall achievement of our strategic objectives with underlying frameworks and limits. The key frameworks and developments this year are described in the relevant section of the following pages.

* unaudited

Introduction* continued

Stress testing

Stress testing commonly describes the evaluation of a bank's financial position under severe but plausible stress scenarios. The term stress testing is used to refer not only to the application of individual stress tests but also to the wider economic environment within which these tests are developed, evaluated and used within the decision making process.

Since the financial crisis of 2008/2009 there has been an increased focus, both amongst regulators and senior management, on stress testing as a means of identifying vulnerabilities within a financial institution and within the financial system as a whole.

Many regulatory documents and initiatives have emerged which require strong involvement of senior management in the design and evaluation of scenarios, an emphasis on plausible events and a shift from the assessment of instant shocks to multi-period analysis of capital adequacy over a prolonged period of stress.

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

The Executive Risk Forum is the main body overseeing the stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any Group-wide stress tests and ensuring, where necessary, appropriate management actions are initiated.

Industry wide scenarios

RBS has taken part in a number of industry wide stress tests such as an EU-wide stress testing exercise, the results of which were published in July 2010.

It is important to note that the tests are theoretical in nature and none of the data published represent a forecast or prediction by RBS of what would actually happen in any of the modelled scenarios. Furthermore, the results are FSA calculations impacting revenues, impairments and balance sheet items and assume an unchanged balance sheet from the end of 2009.

The test confirms RBS remains well capitalised with a strong Tier 1 capital ratio under both the benchmark and adverse scenarios.

In addition to the EU stress test, during the second half of 2010 RBS has undertaken the FSA anchor scenario test.

During 2011, RBS is planning to take part in forthcoming International Monetary Fund, European Banking Federation and FSA stress testing exercises.

Other stress testing

In addition to industry wide stress tests, Group standards for stress testing allow for a combination of various stress testing methods in order to provide a comprehensive view of the Group's risk profile. Depending on the complexity and materiality of the portfolio, techniques may range from sensitivity analyses performed on an individual product or an individual portfolio to the evaluation of complex stress scenarios performed at Group-wide level.

Stress testing techniques applied within the Group are:

- sensitivity analysis;
- scenario analysis; and
- reverse stress testing.

The stress testing programme implemented aims to provide a comprehensive view of the Group's risk profile. Stress tests are performed at the following levels of aggregation:

- firm-wide level;
- division level;
- portfolio level; and
- transactional or sub-portfolio level.

More details on stress and scenario testing are set out in various sub sections in the following pages.

* unaudited

Balance sheet management

All the disclosures in this section (pages 66 to 85) are audited unless otherwise indicated by an asterisk (*).

Capital*

It is the Group's policy to maintain a strong capital base and to utilise it efficiently throughout its activities to optimise the return to shareholders, while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the FSA.

Group Treasury in conjunction with the divisions and Risk Management, in respect of risk-weighted assets (RWAs), manage and control the Group's balance sheet risks and consequent impact on the Group's capital, funding, liquidity, interest rate and currency risks.

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

	Proportional			Statutory		
	2010	2009	2008	2010	2009	2008
Risk-weighted assets	£bn	£bn	£bn	£bn	£bn	£bn
Credit risk	383.0	410.4	433.4	385.9	513.2	551.3
Counterparty risk	68.1	56.5	61.1	68.1	56.5	61.1
Market risk	80.0	65.0	46.5	80.0	65.0	46.5
Operational risk	37.1	33.9	36.8	37.1	33.9	36.9
	568.2	565.8	577.8	571.1	668.6	695.8
Asset Protection Scheme relief	(105.6)	(127.6)	n/a	(105.6)	(127.6)	n/a
	462.6	438.2	577.8	465.5	541.0	695.8
Risk asset ratio	%	%	%	%	%	%
Core Tier 1	10.7	11.0	5.9	10.7	11.0	6.6
Tier 1	12.9	14.4	9.9	12.9	14.1	10.0
Total	14.0	16.3	14.2	14.0	16.1	14.1

Key points

- Credit and counterparty RWAs fell by £15.8 billion principally due to Non-Core disposals partially offset by regulatory and modelling changes.
- Market risk increased by £15.0 billion during the year principally due to an event risk.
- The reduction in APS RWA relief relates to the run-off of covered assets.
- The benefit of the APS to the Core Tier 1 ratio is 1.2% at 31 December 2010 (2009 - 1.6%).
- In May 2010, the Group concluded a series of exchange and tender offers with the holders of a number of Tier 1 and upper Tier 2 securities. As a result of the exchange and tender offers, the Group realised an aggregate post-tax gain of £1.2 billion, which increased the Group's Core Tier 1 capital ratio by approximately 0.3% and resulted in a

reduction in the Group's Total Tier 1 capital ratio of approximately 0.5%.

- During the year the Group increased Core Tier 1 capital by £0.8 billion through the issue of ordinary shares on the conversion of sterling and US dollar non-cumulative convertible preference shares.

As part of the annual planning and budgeting cycle, each division is allocated capital based upon RWAs and associated regulatory deductions. The budgeting process considers risk appetite, available capital resources, stress testing results and business strategy. The budget is agreed by the Board and allocated to divisions to manage their allocated RWAs.

Group Treasury and GALCO monitor available capital and its utilisation across divisions. GALCO makes the necessary decisions around reallocation of budget and changes in RWA allocations.

Individual Capital Adequacy Assessment Process (ICAAP)
In addition to the calculation of minimum capital requirements for credit, market and operational risk, banks are required to undertake an ICAAP for other risks. The Group's ICAAP, in particular, focuses on pension fund risk, interest rate risk in the banking book together with stress tests to assess the adequacy of capital over one year and the economic cycle.

Pillar 3
The Group publishes its Pillar 3 (Market disclosures) on its website, providing a range of additional information relating to Basel II and risk and capital management across the Group. The disclosures focus on capital resources and adequacy, discuss a range of credit risk approaches and their associated RWAs under various Basel II approaches such as credit risk mitigation, counterparty credit risk and provisions. Detailed disclosures are also made on equity, securitisation, operational and market risk, and interest rate risk in the banking book.

* unaudited

Balance sheet management: Capital* continued

Capital resources - proportional

In addition to the fully consolidated basis monitored by the FSA for regulatory purposes, the Group also monitors its regulatory capital resources on a proportional consolidation basis reflecting only those businesses of RBS N.V that are retained by RBS. The Group's regulatory capital resources on a proportional consolidation basis, in accordance with the FSA definitions, were as follows:

Composition of regulatory capital - proportional*	2010 £m	2009 £m	2008 £m
Tier 1			
Ordinary and B shareholders' equity	70,388	69,890	45,525
Non-controlling interests	1,424	2,227	5,436
Adjustments for:			
- goodwill and other intangible assets - continuing businesses	(14,448)	(14,786)	(16,386)
- goodwill and other intangible assets - discontinued businesses	—	(238)	—
- unrealised losses on available-for-sale (AFS) debt securities	2,061	1,888	3,687
- reserves arising on revaluation of property and unrealised gains on AFS equities	(25)	(207)	(984)
- reallocation of preference shares and innovative securities	(548)	(656)	(1,813)
- other regulatory adjustments (1)	(1,097)	(950)	9
Less excess of expected losses over provisions net of tax	(1,900)	(2,558)	(770)
Less securitisation positions	(2,321)	(1,353)	(663)
Less APS first loss	(4,225)	(5,106)	—
Core Tier 1 capital	49,309	48,151	34,041
Preference shares	5,410	11,265	16,655
Innovative Tier 1 securities	4,662	2,772	6,436
Tax on the excess of expected losses over provisions	758	1,020	308
Less material holdings	(310)	(310)	(316)
Total Tier 1 capital	59,829	62,898	57,124
Tier 2			
Reserves arising on revaluation of property and unrealised gains on AFS equities	25	207	984
Collective impairment provisions	764	796	666
Perpetual subordinated debt	1,852	4,200	9,079
Term subordinated debt	16,681	18,120	20,282
Non-controlling and other interests in Tier 2 capital	11	11	11
Less excess of expected losses over provisions	(2,658)	(3,578)	(1,076)
Less securitisation positions	(2,321)	(1,353)	(663)
Less material holdings	(310)	(310)	(316)
Less APS first loss	(4,225)	(5,106)	—
Total Tier 2 capital	9,819	12,987	28,967
Tier 3	—	—	260
Supervisory deductions			

Unconsolidated investments			
- RBS Insurance	(3,962)	(4,068)	(3,628)
- other investments	(318)	(404)	(416)
Other deductions	(452)	(93)	(111)
Deductions from total capital	(4,732)	(4,565)	(4,155)
Total regulatory capital	64,916	71,320	82,196
Note:			
(1) Includes reduction for own liabilities carried at fair value	(1,182)	(1,057)	(1,159)

* unaudited

Balance sheet management: Capital* continued

Capital resources - statutory

The Group's regulatory capital resources on a full consolidation basis, in accordance with the FSA definitions, were as follows:

Composition of regulatory capital - statutory	2010 £m	2009 £m	2008 £m
Tier 1			
Ordinary and B shareholders' equity	70,388	69,890	45,525
Non-controlling interests	1,719	16,895	21,619
Adjustments for:			
- goodwill and other intangible assets - continuing businesses	(14,448)	(17,847)	(20,049)
- goodwill and other intangible assets - discontinued businesses	—	(238)	—
- unrealised losses on available-for-sale (AFS) debt securities	2,061	1,888	3,687
- reserves arising on revaluation of property and unrealised gains on AFS equities	(25)	(207)	(984)
- reallocation of preference shares and innovative securities	(548)	(656)	(1,813)
- other regulatory adjustments (1)	(1,097)	(1,184)	(362)
Less excess of expected losses over provisions net of tax	(1,900)	(2,558)	(770)
Less securitisation positions	(2,321)	(1,353)	(663)
Less APS first loss	(4,225)	(5,106)	—
Core Tier 1 capital	49,604	59,524	46,190
Preference shares	5,410	11,265	16,655
Innovative Tier 1 securities	4,662	5,213	7,383
Tax on the excess of expected losses over provisions	758	1,020	308
Less material holdings	(310)	(601)	(689)
Total Tier 1 capital	60,124	76,421	69,847
Tier 2			
Reserves arising on revaluation of property and unrealised gains on AFS equities	25	207	984
Collective impairment provisions	778	796	666
Perpetual subordinated debt	1,852	4,950	9,829
Term subordinated debt	16,745	20,063	23,162
Non-controlling and other interests in Tier 2 capital	11	11	11
Less excess of expected losses over provisions	(2,658)	(3,578)	(1,078)
Less securitisation positions	(2,321)	(1,353)	(662)
Less material holdings	(310)	(601)	(689)
Less APS first loss	(4,225)	(5,106)	—
Total Tier 2 capital	9,897	15,389	32,223
Tier 3	—	—	260
Supervisory deductions			
Unconsolidated investments			
- RBS Insurance	(3,962)	(4,068)	(3,628)

- other investments	(318)	(404)	(416)
Other deductions	(452)	(93)	(111)
Deductions from total capital	(4,732)	(4,565)	(4,155)
Total regulatory capital	65,289	87,245	98,175
Note:			
(1) Includes reduction for own liabilities carried at fair value	(1,182)	(1,057)	(1,159)

* unaudited