

ROYAL BANK OF SCOTLAND GROUP PLC  
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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer

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

28 May 2009

The Royal Bank of Scotland Group plc

Gogarburn  
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Edinburgh EH12 1HQ  
Scotland  
United Kingdom

(Address of principal executive offices)

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

Form 20-F

Form 40-F

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

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

Yes

No

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

THE ROYAL BANK OF SCOTLAND plc

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## THE ROYAL BANK OF SCOTLAND plc

### Explanatory note

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

### Presentation of information

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

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

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

### International Financial Reporting Standards

As required by the Companies Act 1985 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together ‘IFRS’) as adopted by the European Union. It also complies with IFRS as issued by the IASB. On implementation of IFRS on 1 January 2005, the Group took advantage of the option in IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ to implement IAS 39 ‘Financial Instruments: Recognition and Measurement’ and IAS 32 ‘Financial Instruments: Disclosure and Presentation’ from 1 January 2005 without restating its 2004 income statement and balance sheet. The date of transition to IFRS for the Group and the date of its opening IFRS balance sheet is 1 January 2004.

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

THE ROYAL BANK OF SCOTLAND plc

Forward-looking statements

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

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

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

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

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

## THE ROYAL BANK OF SCOTLAND plc

## SELECTED FINANCIAL DATA

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

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

## Amounts in accordance with IFRS

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

## Note:

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

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

Note:

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

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## THE ROYAL BANK OF SCOTLAND plc

## SELECTED FINANCIAL DATA (continued)

## Other financial data

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

## Notes:

- (1) Return on average total assets represents profit attributable to ordinary shareholders as a percentage of average total assets.
- (2) Return on average ordinary shareholders' equity represents profit attributable to ordinary shareholders expressed as a percentage of average ordinary shareholders' equity.
- (3) For this purpose, earnings consist of income before taxes and minority interests, plus fixed charges less the unremitted income of associated undertakings (share of profits less dividends received). Fixed charges consist of total interest expense, including or excluding interest on deposits and debt securities in issue, as appropriate, and the proportion of rental expense deemed representative of the interest factor (one third of total rental expenses).
- (4) Upon adoption of IFRS by listed banks in the UK on 1 January 2005, the Financial Services Authority ("FSA") changed its regulatory requirements such that the measurement of capital adequacy was based on IFRS subject to a number of prudential filers. The Risk Asset Ratios as at 31 December 2008, 2007, 2006 and 2005 have been presented in compliance with these revised FSA requirements.

## Description of business

### Introduction

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

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

### Organisational structure and business overview

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

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

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

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

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

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



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

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

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

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

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

UK Business & Commercial Banking is the largest provider of banking, finance, and risk management services to the SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes asset finance, in which, according to the Finance Lease Association, it has a strong market presence through the Lombard brand.

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

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

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

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

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

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

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

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

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

Group Manufacturing comprises the Group's worldwide manufacturing operations. It supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Manufacturing drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and has become the centre of excellence for managing large-scale and complex change.

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

#### Non-core division

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

#### Recent developments

##### Asset Protection Scheme

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

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

##### Litigation Update

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

##### Debt Tender and Exchange Offer

On 26 March 2009, RBS Financing Limited ("RBSF"), a subsidiary of the RBS Group, launched a cash tender offer in the United States (the "RBSF US Tender Offer") for any and all of the outstanding securities of ten different series previously issued by the Group and certain of its affiliates. Concurrently therewith, RBSF also launched a cash tender

offer outside of the United States (the “RBSF Non-US Tender Offer”) for five different series of securities previously issued by The Royal Bank and certain of its affiliates and an offer outside of the United States to exchange (the “RBSF Exchange Offer”) any or all of the outstanding securities of fourteen different series previously issued by The Royal Bank and certain of its affiliates for new senior unsecured notes of The Royal Bank.

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

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

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

## Competition

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

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

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

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

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

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

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

In Ireland, Ulster Bank and First Active compete in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market.

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

## Risk factors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Furthermore, even if RBS is able to participate in the APS, there can be no assurance that such participation will enable RBS to achieve all of the stated goals of the APS. While the APS is expected to limit losses associated with assets to be covered by the APS, RBS would remain fully exposed in respect of a specified "first loss" amount and exposed to 10 per cent. of losses exceeding that "first loss" amount. In addition, RBS would continue to be exposed to the risk of losses, impairments and write-downs with respect to assets not covered by the APS. Although RBS would have the option to obtain an additional £6 billion in capital from HM Treasury (in the form of a subscription for

further B Shares) there can be no assurance that such additional capital, together with RBS's strengthened capital position as a result of the Placing and Open Offer, and the capital resulting from the proposed issue of the £6.5 billion and £13 billion of B Shares, will be sufficient to maintain the RBS Group's capital ratios in the event of further losses, which could cause RBS's business, results of operation and financial condition to suffer, its credit rating to drop, its ability to lend and access funding to be further limited, its cost of funding to increase and its Share price to decline, any of which would increase the risk of the full nationalisation of RBS.

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

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

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

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

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

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

At the same time as RBS announced its proposed participation in the APS, RBS announced that, if it participated in the APS, it would issue £6.5 billion of B Shares to HM Treasury. RBS also announced that it would issue a further £13 billion of B Shares to HM Treasury on or after implementation of the APS, and HM Treasury would grant RBS the option to require HM Treasury to purchase a further £6 billion of B Shares from it. The B Shares, if issued, will rank *pari passu* with the Ordinary Shares on a winding-up. The B Shares would be convertible, at the option of the holder at any time, into Ordinary Shares at an initial conversion price of £0.50 per Ordinary Share. HM Treasury would agree not to convert any B Shares it holds if, as a result of such conversion, it would hold 75 per cent. or more of the Ordinary Shares, unless the price of the Ordinary Shares is equal to or exceeds £0.65 for a specified period in which case conversion is mandatory in any event. In addition, HM Treasury will not be entitled to vote in respect of Ordinary Shares acquired by it as a result of the conversion of B Shares into Ordinary Shares to the extent, but only to the extent, that votes cast on such Ordinary Shares, together with any other votes which HM Treasury is entitled to cast in respect of any other Ordinary Shares held by or on behalf of HM Treasury would exceed 75 per cent. of the total votes eligible to be cast on a resolution presented at a general meeting of RBS. If all £25.5 billion of B Shares are issued, such conversion of the B Shares would significantly increase HM Treasury's ownership interest in RBS up to



approximately 84.4 per cent. of the RBS's issued share capital, and have a corresponding dilutive effect on other RBS Shareholders (as would the issue of the B Shares themselves in the event of a winding-up) although any such conversion would have no impact on the RBS Group's Tier 1 capital position. Furthermore, a mandatory conversion of the B Shares by HM Treasury would put RBS in breach of the Listing Rules requirement that 25 per cent. of its issued share capital must be in public hands. Although RBS may apply to the UKLA for a waiver in such circumstances, there is no guarantee that such a waiver would be granted, the result of which could be the delisting of RBS from the Official List and potentially other exchanges where its securities are currently listed and traded.

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

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

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

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

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

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

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

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

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

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

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

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

The RBS Group's ability to engage in routine funding transactions has been and will continue to be adversely affected by the actual or perceived failure or worsening credit of its counterparties, including other financial institutions and corporate borrowers. The RBS Group has exposure to many different industries and counterparties and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients. As a result, defaults by, or even the perceived creditworthiness of or concerns about, one or more corporate borrowers, financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the RBS Group or by other institutions. Many of these transactions expose the RBS Group to credit risk in the event of default of the RBS Group's counterparty or client. In addition, the RBS Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the RBS Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those currently experienced. Any such losses could have a material adverse effect on the RBS Group's results of operations and financial condition or result in a loss of value in RBS shares.

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

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

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

The RBS Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), which are carried at fair value. The fair value of these CDSs, as well as the RBS Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Since 2007, monoline and other insurers and other market counterparties (including credit derivative product companies) have been adversely affected by their exposure to residential mortgage linked and corporate credit products. As a result, their actual and perceived credit worthiness deteriorated significantly in 2008 and may continue to be so impacted in 2009. If the financial condition of these counterparties or their actual and perceived credit worthiness deteriorates further, the RBS Group may record further credit valuation adjustments

on the CDSs bought from these counterparties in addition to those already recorded.

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

Some of the most significant market risks the RBS Group faces are interest rate, foreign exchange, bond, equity and commodity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress, such as those experienced in recent months. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the RBS Group's non-UK subsidiaries (principally ABN AMRO, Citizens and RBS Greenwich Capital) and may affect income from foreign exchange dealing. The performance of financial markets may affect bond, equity and commodity prices and, therefore, cause changes in the value of the RBS Group's investment and trading portfolios. This has been the case during the period since August 2007, with market disruptions and volatility resulting in significant reductions in the value of such portfolios. While the RBS Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult, particularly in the current environment, to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the RBS Group's financial performance and business operations or result in a loss of value in RBS shares.

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

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

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

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

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

Under IFRS, the RBS Group recognises at fair value: (i) financial instruments classified as 'held-for-trading' or 'designated as at fair value through profit or loss'; (ii) financial assets classified as 'available-for-sale'; and (iii) derivatives, each as further described in 'Accounting Policies' on page 64 of the financial statements. Generally, to establish the fair value of these instruments, the RBS Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to changes in market conditions, as has been the case during the current financial crisis. In such circumstances, the RBS Group's internal valuation models require the RBS Group to make assumptions, judgements and estimates to establish fair value. In common with other financial institutions, these internal valuation models are complex, and the assumptions, judgements and estimates the RBS Group is required to make often relate to matters that are inherently uncertain, such as expected cash flows, the ability of borrowers to service debt, residential and commercial property price appreciation and depreciation, and relative levels of defaults and deficiencies. Such assumptions, judgements and estimates may need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the RBS Group's earnings and financial condition. Also, recent market volatility and illiquidity has challenged the factual bases of certain underlying assumptions and has made it difficult to value certain of the RBS Group's financial instruments. Valuations in future periods, reflecting prevailing market conditions, may result in further significant changes in the fair values of these instruments, which could have a negative effect on the RBS Group's results of operations and financial condition or result in a loss of value in RBS shares.

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

In light of the recently changed global economic outlook, the RBS Group has embarked on a restructuring which focused on achieving appropriate risk adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital intensive businesses. The RBS Group will also continue with its disposal programme and continue to review its portfolio to identify further disposals of certain non-core assets. Although the proceeds of the Second Placing and Open Offer improved the quality of the RBS Group's capital by replacing the existing £5 billion of Preference Shares with £5 billion of Core Tier 1 capital, the global credit markets remain challenging and the RBS Group's execution of its current and future strategic plans may not be successful. In

connection with the implementation of these plans, the RBS Group may incur restructuring charges, which may be material. Furthermore, if the RBS Group's plans, including any planned disposals, are not successful or fail to achieve the results expected, the RBS Group's business, capital position financial condition, results of operations and future prospects may be negatively impacted or this could result in a loss of value in RBS shares.

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

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

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

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

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

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

The RBS Group's ability to implement its strategy depends on the ability and experience of its senior management and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a negative impact on the RBS Group's business. The RBS Group's future success will also depend on its ability to attract, retain and remunerate highly skilled and qualified personnel competitively with its peers. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and heightened scrutiny of, and (in some cases) restrictions placed upon, management compensation arrangements, in particular those in receipt of Government funding (such as the RBS Group). The RBS Group recently announced changes to its compensation structure which included significant reductions in bonuses to be paid in respect of 2008, and limitations on pay rises in 2009. In addition to the effects of such measures on the RBS Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is becoming more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of



appropriately skilled personnel could prevent the RBS Group from successfully implementing its strategy, which could have a material adverse effect on the RBS Group's financial condition and results of, operations or result in a loss of value in RBS shares.

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

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

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

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

The RBS Group's results have been and could be further adversely affected in the event of goodwill impairment.

The RBS Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the RBS Group tests goodwill for impairment annually or more frequently, at external reporting dates, when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. The value in use

and fair value of the RBS Group's cash generating units are affected by market conditions and the performance of the economies in which the RBS Group operates. Where the RBS Group is required to recognise a goodwill impairment, it is recorded in the RBS Group's income statement, although it has no effect on the RBS Group's regulatory capital position. For the year ended 31 December 2008, the Group recorded a £8.1 billion accounting write-down of goodwill and other intangibles relating to prior year acquisitions.

The RBS Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations.

The RBS Group maintains a number of defined benefit pension schemes for past and current employees. Pensions risk is the risk that the liabilities of the RBS Group's various defined benefit pension schemes which are long term in nature will exceed the schemes' assets, as a result of which the RBS Group is required or chooses to make additional contributions to the schemes. The schemes' assets comprise investment portfolios that are held to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of these asset portfolios and returns from them may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In these circumstances, the RBS Group could be obliged, or may choose, to make additional contributions to the schemes, and during recent periods, the RBS Group has voluntarily made such contributions. Given the current economic and financial market difficulties and the prospects for them to continue over the near and medium term, the RBS Group may be required or elect to make further contributions to the pension schemes and such contributions could be significant and have a negative impact on the RBS Group's capital position results of operations or financial condition or result in a loss of value in RBS shares.

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

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

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

The RBS Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The RBS Group has complex and geographically diverse operations and operational risk and losses can result from internal or external fraud, errors by employees or third-parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, natural disasters or the inadequacy or failure of systems and controls, including those of the RBS Group's suppliers or counterparties. Although the RBS Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures, to identifying and rectifying weaknesses in existing procedures and to training staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the RBS Group. Any weakness in these systems or controls, or any breaches or alleged breaches of applicable laws or regulations could have a materially negative impact on the RBS Group's business, reputation, results of operations and share price. Notwithstanding anything contained in this risk factor, it should not be taken as implying that either RBS or the RBS Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA.

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

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

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

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

The RBS Group's operations have inherent reputational risk.

Reputational risk, meaning the risk to earnings and capital from negative public opinion, is inherent in the RBS Group's business. Negative public opinion can result from the actual or perceived manner in which the RBS Group conducts its business activities or from actual or perceived practices in the banking and financial industry. Negative public opinion may adversely affect the RBS Group's ability to keep and attract customers and, in particular, corporate and retail depositors. The RBS Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In the United Kingdom and in other jurisdictions, the RBS Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the United Kingdom, the Financial Services Compensation Scheme (the "Scheme") was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The Scheme can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it and, if the Banking Bill is enacted in its current form, may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under that Bill. The Scheme is funded by levies on firms authorised by the FSA, including the RBS Group. In the event that the Scheme raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the RBS Group may have a material impact on its results of operations and financial condition. During the financial year ended 31 December 2008, the RBS Group made a provision of £150 million related to a levy by the Scheme.

In addition, to the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the United States with the Federal Deposit Insurance Corporation), the RBS Group may make further provisions and may incur additional costs and liabilities, which may negatively impact its financial condition and results of operations or result in a loss of value in RBS shares.

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

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

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

The restructuring plan in place for the integration and separation of ABN AMRO into and among the businesses and operations of the consortium members is complex, involving substantial reorganisation of ABN AMRO's operations and legal structure. In addition, the plan contemplates activities taking place simultaneously in a number of businesses and jurisdictions. Although integration efforts are well underway and are being advanced on a number of fronts, the implementation of the reorganisation and the realisation of the forecast benefits within the planned timescales,

particularly given current market and economic conditions, remains challenging, although the RBS Group remains confident that such goals will be achieved. Execution of the restructuring requires management resources previously devoted to the RBS Group businesses and the retention of appropriately skilled ABN AMRO staff. The RBS Group may not realise the benefits of the acquisition or the restructuring when expected or to the extent projected. The occurrence of any of these events, including as a result of staff losses or performance issues, may have a negative impact on the RBS Group's financial condition and results of operations. It is not expected that the Dutch State's acquisition of Fortis Bank Nederland's shares in RFS Holdings, which was effected in December 2008, will materially affect the integration benefits envisaged by the RBS Group.

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

In accordance with IFRS, the RBS Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The losses are quantified on the basis of current tax legislation and are subject to change in respect of the rate of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation may reduce the recoverable amount of the recognised deferred tax assets.

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

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

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

#### Risk, capital and liquidity management

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

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

#### Risk governance (unaudited)

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

The role and remit of these committees is as follows:

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

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

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

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

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

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

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

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

#### Risk and capital (unaudited)

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

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





## Risk appetite (unaudited)

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

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

- Quantitative: encompassing stress testing, risk concentration, value-at-risk, liquidity and credit related metrics.
- Qualitative: focusing on ensuring that the RBS Group applies the correct principles, policies and procedures.

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

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

The main risks facing the RBS Group are as follows:

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

- **Funding and liquidity risk:** the risk that the RBS Group is unable to meet obligations as they fall due.
- **Market risk:** the risk that the value of an asset or liability may change as a result of a change in market rates.

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

- **Regulatory risk:** the risks arising from regulatory changes/enforcement.
- **Other risk:** the risks arising from reputation and pension fund risk.

## Credit risk

### Principles for credit risk management (audited)

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

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

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

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

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

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

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

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

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

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

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

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

**Credit risk models (audited)**

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

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

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

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

**Model validation (audited)**

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

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

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

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

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

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

Credit risk mitigation (audited)

The RBS Group takes a number of steps to mitigate credit risk. The key risk mitigants are as follows:

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

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

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

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

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

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

Credit risk assets (audited)

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

Credit concentration risk (including country risk) (audited)

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

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

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

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

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

Global Restructuring Group (GRG) (audited)

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

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

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

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

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

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

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

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

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

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

Retail collections and recoveries (audited)

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

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

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

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

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

## Credit risk asset quality (audited)

Internal reporting and oversight of risk assets is principally differentiated by credit grades. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the RBS Group map to both a RBS Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across disparate portfolios. Accordingly, measurement of risk is easily aggregated and can be reported at increasing levels of granularity depending on audience and business need.

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

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

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

## Asset grades (unaudited)

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

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

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

	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Group Balances with Group Accruing past due		No impairment accrual provision		Total £m
						£m	£m	£m	£m	
2008 Cash and balances at central banks	6,806	—	—	—	—	—	—	—	—	6,806
Loans and advances to banks (1)	68,885	91	77	28	230	7,297	—	83	(83)	76,608
Loans and advances to customers	231,688	108,005	144,408	74,314	36,736	4,484	12,797	13,643	(6,572)	619,503
Debt securities	171,685	847	263	3,736	1,220	—	—	33	(18)	177,766
Settlement balances	5,651	516	290	129	256	—	4,029	—	—	10,871
Derivatives	812,895	33,632	24,984	4,077	5,434	56,424	11	—	—	937,457
Other financial instruments	32	—	—	—	—	—	—	—	—	32
	1,297,642	143,091	170,022	82,284	43,876	68,205	16,837	13,759	(6,673)	1,829,043
Commitments	173,350	44,710	43,765	20,983	18,278	51	—	—	—	301,137
Contingent liabilities	20,946	5,976	2,989	2,519	487	—	—	—	—	32,917
Total off-balance sheet	194,296	50,686	46,754	23,502	18,765	51	—	—	—	334,054



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

Note:

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

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

sheet

Note:

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

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## Industry risk – geographical analysis (audited)

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

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

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

## Notes:

- (1) Includes settlement balances of £10,871 million.
- (2) This column shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

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

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

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## Industry risk – geographical analysis (audited) continued

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



Notes:

- (1) Includes settlement balances of £5,326 million.
- (2) This column shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

2008	Bank			Settlement balances £m	Total £m	Netting offset(1) £m
	Loans and advances to banks and customers £m	Debt securities and equity shares £m	Derivatives £m			
UK						
Central and local government	3,559	33,099	4,003	1	40,662	352
Manufacturing	16,047	263	5,516	15	21,841	1,904
Construction	6,614	33	687	—	7,334	405
Finance	167,225	101,653	502,642	3,462	774,982	426,102
Service industry and business activities	57,456	4,787	11,935	478	74,656	2,290
Agriculture, forestry and fishing	836	—	21	1	858	71
Property	44,390	2,296	4,509	2	51,197	433
Individuals:						
Home mortgages	39,409	—	5			