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

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

FORM 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2010

OR

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

OR

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

Commission file number: 001-10306

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

United Kingdom
(Jurisdiction of incorporation or organization)

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

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

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

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

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

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

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

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

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

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

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

x Yes o No

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

o Yes x No

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

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

x Yes o No

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

o Yes o No

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

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

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

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

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

o Item 17 o Item 18

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

o Yes x No

SEC Form 20-F cross reference guide

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Contents

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

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

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

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

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

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

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

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

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

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

Statutory results

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

Glossary

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

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

In particular, this document includes forward-looking statements relating, but not limited to: the Group’s restructuring plans, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets, return on equity (ROE), cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; the Group’s future financial performance; the level and extent of future impairments and write-downs; the protection provided by the Asset Protection Scheme (APS); and the Group’s potential exposures to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain of the market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: the full nationalisation of the Group or other resolution procedures under the Banking Act 2009; the global economy and instability in the global financial markets, and their impact on the financial industry in general and on the Group in particular; the financial stability of other financial institutions, and the Group’s counterparties and borrowers; the ability to complete restructurings on a timely basis, or at all, including the disposal of certain Non-Core assets and assets and businesses required as part of the EC State Aid restructuring plan; organisational restructuring; the ability to access sufficient funding to meet liquidity needs; the extent of future write-downs and impairment charges caused by depressed asset valuations; the inability to hedge certain risks economically; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the United States; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; ineffective management of capital or changes to capital adequacy or liquidity requirements; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; HM Treasury exercising influence over the operations of the Group; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group’s operations) in the United Kingdom, the United States and other countries in which the Group operates or a change in United Kingdom Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G7 central banks; impairments of goodwill; pension fund shortfalls; litigation and regulatory investigations; general operational risks; insurance claims; reputational risk; general geopolitical and economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the ability to achieve revenue benefits and cost savings from the integration of certain of RBS Holdings N.V.’s (formerly ABN AMRO Holding N.V.) businesses and assets; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; the participation of the Group in the APS and the effect of the APS on the Group’s financial and capital position; the ability to access the contingent capital arrangements with HM Treasury; the conversion of the B shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group’s activities as a result of HM Treasury’s investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

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

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

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

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

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

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

Organisational structure and business overview
The Group's activities are organised on a divisional basis as follows:

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

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

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

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

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

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

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

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

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

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

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

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

Business divestments

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

Recent developments

Gender equality in insurance contracts

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

Budget update

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

Personal current accounts

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

US dollar clearing activities

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

Competition

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

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

In asset finance, the Group competes with banks and specialised asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets the Group competes with the large domestic banks active in these markets and with the major international banks. In the small business banking market, the Group competes with other UK clearing banks, specialist finance providers and building societies.

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

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

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

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

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

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

Risk factors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Key financials

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

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

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

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

Summary consolidated income statement

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

2010 compared with 2009

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

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

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

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

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

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

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

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

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

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

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

Tax

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

Earnings

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

2009 compared with 2008

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

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

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

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

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

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

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

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

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

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

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

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

Analysis of results

Net interest income

	2010	2009	2008
	£m	£m	£m
Interest receivable	22,776	33,836	49,522
Interest payable	(8,567)	(17,332)	(30,847)
Net interest income	14,209	16,504	18,675

	%	%	%
Gross yield on interest-earning assets of the banking business (1)	3.30	3.76	5.61
Cost of interest-bearing liabilities of the banking business	(1.47)	(2.18)	(3.79)
Interest spread of the banking business (2)	1.83	1.58	1.82
Benefit from interest-free funds	0.23	0.25	0.30
Net interest margin of the banking business (3)	2.06	1.83	2.12

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

Notes:

(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.

(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.

(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

Average balance sheet and related interest

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

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

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

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Average balance sheet and related interest continued

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

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

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

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

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

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

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

Note:

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

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

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

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

Note:

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

Non-interest income

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

2010 compared with 2009

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

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

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

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

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

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

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Non-interest income continued

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

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

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

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

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

Operating expenses

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

2010 compared with 2009

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

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

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

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

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

2009 compared with 2008

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

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

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

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

Integration costs

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

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

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

Accruals in relation to integration costs are set out below.

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

Restructuring costs

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

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

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

Accruals in relation to restructuring costs are set out below.

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

Divestment costs

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

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

Accruals in relation to divestment costs are set out below.

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

Impairment losses

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

2010 compared with 2009
Impairment losses were £9,256 million, compared with £13,899 million in 2009. The 33% decrease reflects an overall improvement in the economic environments in which the Group operates.

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

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

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

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

2009 compared with 2008
Impairment losses were £13,899 million compared with £7,439 million. Impairment losses in the Core divisions increased by £2,182 million, Non-Core losses increased by £4,285 million off-set by a decrease in RFS Holdings minority interest of £7 million.

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

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

Credit market exposures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Tax

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

nm = not meaningful

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

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

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

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

Divisional performance

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

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

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

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

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

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

Divisional performance continued

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

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

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

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

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

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

UK Retail

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

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

Notes:

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

(2) Adjusted cost:income ratio is based on total income after netting insurance claims, and operating expenses.

UK Retail continued

2010 compared with 2009

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

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

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

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

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

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

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

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

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

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

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

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

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

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UK Retail continued

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

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

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

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

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

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

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

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

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

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

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

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

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

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

UK Corporate

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

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

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

UK Corporate continued

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

2010 compared with 2009
Operating profit grew by £338 million, 30%, compared with 2009, driven by strong income growth and significantly lower impairments, partially offset by higher costs.

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

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

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

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

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

2009 compared with 2008

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

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

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

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

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

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

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

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

Wealth

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

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

Wealth continued

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

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

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

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

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

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

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

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

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

Global Transaction Services

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

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

Global Transaction Services continued

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

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

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

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

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

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

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

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

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

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

Ulster Bank

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

Note:

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

Ulster Bank continued

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

2010 compared with 2009
Overall performance deteriorated in 2010, largely as a result of an increase in impairment losses of £512 million. Operating profit before impairment increased to £400 million, up 42%, or 50% in constant currency terms, driven by the culmination of a bank-wide cost saving programme during 2010.

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

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

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

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

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

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

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

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

2009 compared with 2008

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

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

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

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

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

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

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

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

US Retail & Commercial

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

Performance ratios

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

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

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

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

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

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

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

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

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

before tax of $174 million was recorded.

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

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

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

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

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

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

Global Banking & Markets

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

Notes:

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

Business review continued

Business review

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Global Banking & Markets continued

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

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

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

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

RBS Insurance

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

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

For notes relating to this table refer to page 46.

RBS Insurance continued

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

Notes:

(1) Other is predominantly made up of the discontinued personal lines broker business.

(2) Total in-force policies include travel and creditor policies sold through RBS Group. These comprise travel policies included in bank accounts e.g. Royalties Gold Account, and creditor policies sold with bank products including mortgage, loan and card repayment payment protection.

(3) Divisional return on equity is based on divisional operating (loss)/profit after tax, divided by divisional average notional equity (based on regulatory capital).

(4) Loss ratio is based on net claims divided by net premium income for the UK businesses.

(5) Commission ratio is based on fees and commissions divided by gross written premium income for the UK businesses.

(6) Expense ratio is based on expenses (excluding fees and commissions) divided by gross written premium income for the UK businesses.

(7) Combined operating ratio is expenses (including fees and commissions) divided by gross written premium income, added to the loss ratio, for the UK businesses.

2010 compared with 2009

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Central items

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

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

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

2010 compared with 2009

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

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

2009 compared with 2008

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

Non-Core

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

Notes:

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

(2) Includes disposal groups.

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

Non-Core continued

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

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

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

Notes:

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

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

(3) Includes disposal groups.

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

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

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

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Non-Core continued

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Consolidated balance sheet at 31 December 2010

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

Commentary on consolidated balance sheet

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

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

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

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

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

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

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

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

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

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

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

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

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

Commentary on consolidated balance sheet

2009 compared with 2008

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Cash flow

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

2010

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

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

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

2009

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

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

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

2008

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

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

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

Capital resources

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

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

Note:

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

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

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

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

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

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

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

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

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

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

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

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

* unaudited

Introduction* continued

Governance

Risk and balance sheet management strategies are owned and set by the Group's Board of directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy, as set out below. Representation by, and interaction between, the individual risk disciplines is a key feature of the governance structure, with the aim of promoting cross-risk linkages. The roles and responsibilities fulfilled by the key risk committees have been reviewed and more clearly defined during the course of 2010.

* unaudited

Introduction* continued

Governance continued

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

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

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

* unaudited

Introduction* continued
Governance continued

Committee	Focus	Membership
Executive Risk Forum (ERF)	Acts on all strategic risk and control matters across the Group including, but not limited to, credit risk, market risk, operational risk, compliance and regulatory risk, enterprise risk, treasury and liquidity risk, reputational risk, insurance risk and country risk.	Group Chief Executive Head of Restructuring and Risk Deputy Group Chief Risk Officer Group Finance Director Chief Executive from each division
Group Asset and Liability Committee (GALCO)	Identifies, manages and controls Group balance sheet risks.	Group Finance Director Director, Group Finance Head of Restructuring and Risk Chief Executive Officer from each division Group Chief Accountant Group Treasurer Group Head of Capital Management Global Head of Balance Sheet Management, Group Treasury Global Head of Markets Head of Non-Core division
Group Risk Committee (GRC)	Recommends and approves limits, policies, processes and procedures to enable the effective management of risk across the Group.	Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer Global Head of: Market and Insurance Risk; Operational Risk; Country Risk and Firm Wide Risk Director, Group Finance Chief Operating Officer, RBS Risk Management Director Group Compliance Director Group Regulatory Affairs Divisional Chief Executive Officers' nominees Chief Administrative Officer's nominee for Business Services Divisional Chief Risk Officers Chief Operating Officer Global Restructuring Group

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

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

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

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

* unaudited

Introduction* continued

Risk coverage

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

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

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

* unaudited

Introduction* continued
Risk coverage continued

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

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

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

* unaudited

Introduction* continued

Stress testing

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

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

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

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

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

Industry wide scenarios

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

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

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

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

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

Other stress testing

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

Stress testing techniques applied within the Group are:

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

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

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

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

* unaudited

Balance sheet management

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

Capital*

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

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

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

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

Key points

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

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

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

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

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

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

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

* unaudited

Balance sheet management: Capital* continued

Capital resources - proportional

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

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

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

* unaudited

Balance sheet management: Capital* continued

Capital resources - statutory

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

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

- other investments	(318)	(404)	(416)
Other deductions	(452)	(93)	(111)
Deductions from total capital	(4,732)	(4,565)	(4,155)
Total regulatory capital	65,289	87,245	98,175

Note:

(1) Includes reduction for own liabilities carried at fair value	(1,182)	(1,057)	(1,159)

* unaudited

Balance sheet management: Capital* continued

The tables below analyse the movement in the year of Core Tier 1 capital on a proportional and statutory basis.

Movement in Core Tier 1 capital - proportional	2010 £m
At beginning of the year	48,151
Attributable loss net of movements in fair value of own debt	(1,250)
Gain on redemption of equity preference shares recorded in equity	651
Foreign currency reserves	610
Issue of ordinary shares	804
Impact of disposals	
- reduction in non-controlling interests	(729)
- reduction in intangibles	754
Decrease in capital deductions including APS first loss	571
Other movements	(253)
At end of the year	49,309

Movement in Core Tier 1 capital - statutory	2010 £m
At beginning of the year	59,524
Attributable loss net of movements in fair value of own debt	(1,250)
Gain on redemption of equity preference shares recorded in equity	651
Foreign currency reserves	610
Issue of ordinary shares	804
Impact of disposals	
- reduction in non-controlling interests	(15,107)
- reduction in intangibles	3,732
Decrease in capital deductions including APS first loss	571
Other movements	69
At end of the year	49,604

Risk-weighted assets by division

Risk-weighted assets by risk category and division on a proportional basis are set out below:

2010	Credit risk £bn	Counterparty risk £bn	Market risk £bn	Operational risk £bn	Total £bn	APS £bn	Total £bn
UK Retail	41.7	—	—	7.1	48.8	(12.4)	36.4
UK Corporate	74.8	—	—	6.6	81.4	(22.9)	58.5
Wealth	10.4	—	0.1	2.0	12.5	—	12.5
Global Transaction Services	13.7	—	—	4.6	18.3	—	18.3
Ulster Bank	29.2	0.5	0.1	1.8	31.6	(7.9)	23.7
US Retail & Commercial	52.0	0.9	—	4.1	57.0	—	57.0
Retail & Commercial	221.8	1.4	0.2	26.2	249.6	(43.2)	206.4

Global Banking & Markets	53.5	34.5	44.7	14.2	146.9	(11.5)	135.4
Other	16.4	0.4	0.2	1.0	18.0	—	18.0
Core	291.7	36.3	45.1	41.4	414.5	(54.7)	359.8
Non-Core	91.3	31.8	34.9	(4.3)	153.7	(50.9)	102.8
Group	383.0	68.1	80.0	37.1	568.2	(105.6)	462.6

* unaudited

Balance sheet management: Capital* continued

Asset Protection Scheme

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

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

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

Regulatory capital impact of the APS

Methodology

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

- First loss - the residual first loss, after impairments and write-downs, to date, is deducted from available capital split equally between Core Tier 1 and Tier 2 capital;

- HM Treasury share of covered losses - after the first loss has been deducted, 90% of assets covered by HM Treasury are risk-weighted at 0%; and

- RBS share of covered losses - the remaining 10% share of loss is borne by RBS and is risk-weighted in the normal way.

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

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

Impact

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

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

For further information on the APS see page 161.

* unaudited

Balance sheet management: Capital* continued
Regulatory developments

Basel III and CRD IV
The Basel Committee released the final text on the new Basel III Capital and Liquidity Frameworks in December 2010, the contents of which were broadly as expected. Whilst most of the new rules are 'final' there are lengthy observation periods for the more novel elements (the liquidity coverage ratio, the net stable funding ratio and the leverage ratio) designed to identify any unintended consequences prior to full implementation and it is possible that some of the detail may be amended. The capital requirements for credit valuation adjustments (CVAs) with respect to counterparty risk are subject to a final impact assessment which is being carried out in the first quarter of 2011. The Committee's guidance on the countercyclical capital buffers allows for significant judgement which will need to be clarified by national regulators. The potential impacts for RBSG are set out below.

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

The focus will now be on the EU's implementation of the Basel framework. The Commission's legislative proposal - the Capital Requirements Directive (CRD) IV - is expected to appear in summer 2011.

Contingent capital and loss absorbency
The Basel Committee issued its final rules on the requirements to ensure all classes of capital instruments fully absorb losses at the point of non-viability, before tax payers are exposed to loss. These are designed to combat the experience during the crisis where holders of Tier 2 capital instruments did not suffer any losses when banks were bailed out by the public sector. Debate continues, meanwhile, over possible requirements for bailing-in senior debt holders, as a further means of protecting the taxpayer.

Implementation by the Group
RBS is advanced in its planning to implement these new measures and is appropriately well-capitalised with tangible equity of £56 billion, Core Tier 1 capital of £49 billion and a Core Tier 1 ratio of 10.7% at 31 December 2010.

Set out below are indicative impacts and timings of the major Basel 2.5 and Basel III proposals on the Group's Core Tier 1 ratio. The estimates are still subject to change; a high degree of uncertainty still remains around implementation details as the guidelines are not fully finalised and must still be converted into rules by the FSA.

A substantial part of the mitigating impacts mentioned in the following paragraphs relate to run-off in the normal course of business and de-leveraging of legacy positions and securitisations, including Non-Core. The Group is also devoting considerable resource to enhancing its models to improve management of market and counterparty exposures. A key mitigating action related to counterparty risk involves enhancement to internal models, which is a significant undertaking. There could be various hedging strategies and business decisions taken as part of mitigation which may have an adverse, but manageable, impact on revenues.

CRD3 (Basel 2.5): Published rules for market risk and re-securitisations. Proposed implementation date 31 December 2011
The estimated impact at the end of 2011 on RWAs post mitigation is an increase of £25 billion to £30 billion, split equally between GBM and Non-Core.

Basel III Counterparty risk: Proposed implementation date 1 January 2013
The impact on RWAs on implementation in 2013 is currently estimated at £45 to £50 billion post mitigation and deleveraging, although there may still be movement in the final framework around this risk.

Basel III Securitisations: Proposed implementation date 1 January 2013
Under the proposals, current deductions under Basel II (50% Core Tier 1, 50% Tier 2) for securitisation positions are switched to RWAs weighted at 1,250%. Post the run-off of securitisation positions and mitigating actions, the impact on implementation in 2013, on RWAs is estimated to be an increase of £30 billion to £35 billion with a corresponding reduction in deductions from Core Tier 1 and Tier 2 capital of £1.2 billion to £1.5 billion each. The impact net RWA equivalent of this change assuming a 10% Core Tier 1 ratio would be an increase in net RWA equivalents of £18 billion to £20 billion.

Summary impacts
The extent of the individual areas of impact, as set out above, may continue to change over time. As previously indicated, however, the overall impact on RWAs of CRD III and CRD IV after mitigation and deleveraging is estimated to be £100 billion to £115 billion, before allowing for the offsetting reduction in deductions.

The impact referenced above would lower the Core Tier 1 ratio by approximately 1.3%, assuming RWAs of £600 billion and a Core Tier 1 ratio of 10%.

* unaudited

Balance sheet management: Capital* continued
Regulatory developments continued

Basel III capital deductions and regulatory adjustments
In addition to the changes outlined above, Basel III will also result in revisions to regulatory adjustments and capital deductions. These will be phased in over a five year period from 1 January 2014. The initial deduction is expected to be 20%, rising 20 percentage points each year until full deduction by 1 January 2018. However, this is subject to final implementation rules determined by the FSA. The proportion not deducted in the transition years will continue to be subject to existing national treatments.

The major categories of deductions include:

- expected loss net of provisions;
- deferred tax assets not relating to timing differences;
- unrealised losses on available-for-sale securities; and
- significant investments in non-consolidated financial institutions.

The net impact of these adjustments is expected to be manageable as most of these drivers reduce or are eliminated by 2014.

Other regulatory developments
Treatment of Systemically Important Financial Institutions (SIFIs)
Policy development around contingent capital and loss absorbency forms part of a wider policy initiative on addressing systemic institutions. A Financial Stability Board outline framework and plan of action was endorsed by G20 leaders at the November 2010 Seoul Summit. This now forms the main focus of global policy making following the finalisation of the Basel III framework. Policy initiatives in this area may include proposals for greater loss absorbency for systemic firms, the development of enhanced supervision and resolution frameworks, as well as recovery and resolution plans.

The EU Commission Consultation
Crisis management proposals
The EU Commission issued a consultation paper on crisis management measures in January 2011. It covers prevention tools (such as recovery planning requirements, supervisory powers and new ideas on intra-group financial support mechanisms), as well as resolution tools (including partial transfer powers and possible approaches to debt write-down. The consultation will inform draft implementing legislation expected this summer, and is intended to help shape the global framework for SIFIs.

Markets in Financial Instruments Directive Review
The EU Commission published a consultation on revising the Directive on Markets in Financial Instruments (MiFID2). The main proposals in the consultation are the extension of the transparency rules to include bonds and over the counter derivatives, measures to reinforce regulation of commodity derivatives and high frequency trading, strengthening investor protection and detailing the role of the new European Securities and Markets Authority.

Financial activities tax
In a recent speech, the EU Tax Commissioner talked about the introduction of a potential Financial Activities Tax at a European level. There will be an impact assessment in 2011 to review the cumulative impact on financial institutions of new regulation, bank levy and taxes, as part of the Commission's on-going examination of possible tax measures.

Dodd-Frank
In the United States the Dodd-Frank Wall Street Reform and Consumer Reform Act (Dodd-Frank) contains very significant reforms the full effect of which can only be assessed when the implementation rules are finalised. There have also been numerous derivative proposals from the Commodity Futures Exchange Commission (CFTC) and the Securities and Exchange Commission (SEC) plus joint agency proposals to implement minimum capital standards (Collins Amendment) and market risk capital guidelines.

Project Merlin
On 9 February 2011, the UK Government and the major British banks including the Group, announced the creation of an accord, known as Project Merlin, aimed at demonstrating the clear and shared intent to work together to help the UK economy recover and grow. The banks:

- will work to foster credit demand, particularly among small and medium-sized businesses, and will make available additional lending capacity if demand should materialise above their current expectations;

- expect to contribute more in UK tax as their performance strengthens and their profits grow and will jointly contribute an additional £1 billion to the Business Growth Fund;

- confirm that the aggregate 2010 bonus pool including deferrals for their UK-based staff will be lower than that of 2009 and will reflect the engagement each bank has had with the Financial Services Authority, the UK Government and its shareholders, as well as their duty to manage pay policy to protect and enhance the long-term interests of shareholders; and

    - will extend disclosure of remuneration details of their most senior executives beyond international norms.

The Government has in the light of the banks’ statements affirmed its commitment to maintaining a strong, resilient, stable and globally competitive UK financial services sector, and to implementing and applying European and international regulation to create a level playing field in both policy and practice.

* unaudited

Balance sheet management: Capital* continued
Other regulatory developments continued

Structure of prudential regulation in the UK
Following the consultation by HM Treasury on ‘A new approach to financial regulation’ in 2010, the government subsequently published further detailed proposals to give the Bank of England responsibility for prudential regulation, and to create a new Consumer Protection and Markets Authority to protect the interests of bank customers.

Increase in the level of customer protection under Financial Services Compensation Scheme
The European Commission has introduced a uniform compensation level of €100,000 across Member States from 1 January 2011. The sterling equivalent was confirmed by HM Treasury as £85,000.

Independent Commission on Banking
The Independent Commission on Banking has published responses from banks, academics and other interested parties to its initial consultation. In its summary of the evidence received the Commission noted that there was considerable interest, both positive and negative, in the question of splitting retail and investment banks. The Commission plans to publish its interim report in April.

FSA Code on remuneration
In July 2009 the European Commission adopted a proposal to further amend the Capital Requirements Directive (CRD) which included proposals on remuneration policies. This was subsequently voted for and approved (CRD III).

CRD III required the Commission of European Banking Supervisors (CEBS) to issue guidelines on sound remuneration policies which comply with its principles and these were issued on 10 December 2010 (the “Guidelines”).

The FSA amended its Remuneration Code to take into account the Guidelines and published its policy statement on remuneration on 17 December 2010.

The Group is required to be compliant with the FSA Remuneration Code with effect from 1 January 2011:

- as a “Tier 1” organisation, the Code applies to all employees on a global basis;
- there are specific remuneration and governance requirements in relation to “Code Staff”; and
- following an ongoing review of our remuneration arrangements and discussions with the FSA, 2011 RBS remuneration arrangements are fully compliant with the FSA Remuneration Code.

Bank levy
In his 22 June 2010 budget statement, the Chancellor announced that the UK Government will introduce an annual bank levy. The Finance Bill 2011 contains details of how the levy will be calculated and collected. The levy will be collected through the existing quarterly corporation tax collection mechanism starting with payment dates on or after the date the Finance Bill 2011 receives Royal Assent. Further information is included on page 309.

Stress and scenario testing
Stress testing forms part of the Group’s risk and capital framework and is an integral component of Basel II. As a key risk management tool, stress testing highlights to senior management potential adverse unexpected outcomes related

to a mixture of risks and provides an indication of how much capital might be required to absorb losses, should adverse scenarios occur. Stress testing is used at both a divisional and Group level to assess risk concentrations, estimate the impact of stressed earnings, impairments and write-downs on capital. It determines the overall capital adequacy under a variety of adverse scenarios. The principal business benefits of the stress testing framework include: understanding the impact of recessionary scenarios; assessing material risk concentrations; and forecasting the impact of market stress and scenarios on the Group's balance sheet liquidity.

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

- macroeconomic stress testing considers the impact on both earnings and capital for a range of scenarios. They entail multi-year systemic shocks to assess the Group's ability to meet its capital requirements and liabilities as they fall due in a downturn in the business cycle and/or macroeconomic environment;

- enterprise-wide stress testing considers scenarios that are not macroeconomic in nature but are sufficiently broad to impact across multiple risks or divisions and are likely to affect earnings, capital and funding;

- cross-divisional stress testing includes scenarios which have impacts across divisions relating to sensitivity to a common risk factor(s). This would include, for example, sector based stress testing across corporate portfolios and sensitivity analysis to stress in market factors. These stress tests are discussed with senior divisional management and are reported to senior committees across the Group; and

- divisional and risk specific stress testing is undertaken to support risk identification and management. Examples include the daily product based stress testing using a hybrid of hypothetical and historical scenarios within market risk.

Portfolio analysis, using historic performance and forward looking indicators of change, uses stress testing to facilitate the measurement of potential exposure to events and seeks to quantify the impact of an adverse change in factors which drive the performance and profitability of a portfolio.

* unaudited

Balance sheet management: Funding and liquidity risk

All disclosures in this section (pages 74 to 85) are audited unless indicated otherwise with an asterisk (*).

Introduction

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

Diversification of the Group's funding base is central to the liquidity management strategy. The Group's businesses have developed large customer franchises, the largest being in the UK, US and Ireland but extend into Europe, Asia and Latin America. Customer deposits provide large pools of stable funding to support the majority of the Group's lending. It is a strategic objective to improve the Group's loan to deposit ratio to 100%, or better, by 2013.

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

Stress testing

Simulated liquidity stress testing is periodically performed for each business and applied to the major operating subsidiary balance sheets. A variety of firm-specific and market related scenarios are used at the consolidated level and in individual countries. These scenarios include assumptions about significant changes in key funding sources, credit ratings, contingent uses of funding, and political and economic conditions in certain countries. Stress tests are regularly updated based on changing market conditions.

Contingency planning

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

Liquidity reserves

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

Regulatory oversight

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

The Group's lead regulator is the Financial Services Authority (FSA). The FSA implemented a new liquidity regime on 1 June 2010. The new rules provide a standardised approach applied to all UK banks. At RBS, the rules focus on the RBS UK Defined Liquidity Group (a subset comprising the Group’s five main UK banks, The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company) and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment (ILAA) process. The ILAA informs the Board and FSA of the assessment and quantification of the Group’s liquidity risks and their mitigation, and how much current and future liquidity is required. The ILAA was approved by the Board in November 2010. The FSA is expected to issue ‘Individual Liquidity Guidance’ to the Group in 2011.

In the US, the Group’s operations are required to meet liquidity requirements set out by the US Federal Reserve Bank, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Financial Industry Regulatory Authority. In the Netherlands, the Group is subject to the De Nederlandsche Bank liquidity oversight regime.

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

In December 2010, the BCBS issued the ‘International framework for liquidity risk measurement, standards and monitoring’ which confirmed the introduction of two liquidity ratios, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The introduction of both of these will be subject to an observation period, which includes review clauses to address and identify any unintended consequences.

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

* unaudited

Balance sheet management: Funding and liquidity risk continued

Funding sources

The table below shows the composition of the Group's primary funding sources, excluding repurchase agreements.

	2010		2009		2008	
	£m	%	£m	%	£m	%
Deposits by banks						
- cash collateral	28,074	3.8	32,552	4.0	45,783	4.8
- other	37,864	5.1	83,090	10.3	133,160	14.0
	65,938	8.9	115,642	14.3	178,943	18.8
Debt securities in issue						
- commercial paper	26,235	3.5	44,307	5.5	69,891	7.3
- certificates of deposits	37,855	5.1	58,195	7.2	73,925	7.8
- medium-term notes and other bonds	131,026	17.7	125,800	15.6	108,529	11.4
- covered bonds	4,100	0.6	—	—	—	—
- other securitisations	19,156	2.6	18,027	2.2	17,113	1.8
	218,372	29.5	246,329	30.5	269,458	28.3
Subordinated liabilities	27,053	3.7	31,538	3.9	43,678	4.6
Total wholesale funding	311,363	42.1	393,509	48.7	492,079	51.7
Customer deposits						
- cash collateral	10,433	1.4	9,934	1.2	18,344	1.9
- other	418,166	56.5	404,317	50.1	441,974	46.4
Total customer deposits	428,599	57.9	414,251	51.3	460,318	48.3
Total funding	739,962	100.0	807,760	100.0	952,397	100.0

Key points

- The Group has continued to reduce reliance on wholesale funding and diversify funding sources. Deposits by banks were reduced by 43% since 31 December 2009.

- The Group has increased the proportion of its funding from customer deposits during 2010, from 51% at 31 December 2009 to 58% at 31 December 2010.

    - The Group was able to reduce short-term wholesale borrowing by £93 billion to £157 billion (including £63 billion of deposits from banks) during the year. Short-term wholesale funding excluding derivative collateral decreased from £216 billion at 31 December 2009 to £129 billion at 31 December 2010.

Balance sheet management: Funding and liquidity risk continued

The tables below show the Group's debt securities in issue and subordinated liabilities by maturity.

2010	Debt securities in issue £m	Subordinated liabilities £m	Total £m	%
Less than one year	94,048	964	95,012	38.7
1-5 years	71,955	9,230	81,185	33.1
More than 5 years	52,369	16,859	69,228	28.2
	218,372	27,053	245,425	100.0
2009				
Less than one year	136,901	2,144	139,045	50.0
1-5 years	70,437	4,235	74,672	26.9
More than 5 years	38,991	25,159	64,150	23.1
	246,329	31,538	277,867	100.0
2008				
Less than one year	170,240	1,994	172,234	55.0
1-5 years	56,109	5,733	61,842	19.8
More than 5 years	43,109	35,951	79,060	25.2
	269,458	43,678	313,136	100.0

Key points

- The Group has improved its funding and liquidity position by extending the average maturity of debt securities in issue.

- The proportion of debt instruments with a remaining maturity of greater than one year has increased in 2010 from 50% at 31 December 2009 to 61% at 31 December 2010.

Short-term borrowings*

The table below shows details of the Group's short-term borrowings.

Short-term borrowings comprise repurchase agreements, borrowings from financial institutions, commercial paper and certification of deposit. Derivative collateral received from financial institutions is excluded from the table below as are long-term borrowings by US Retail & Commercial from Federal Home Loan Banks.

	Repos	Financial institutions (1, 2)	Commercial paper	Certificates of deposits	Total 2010	Total 2009	Total 2008
At year end							
- balance (£bn)	115	42	26	38	221	242	347
- weighted average interest rate	0.5%	0.6%	0.7%	0.6%	0.6%	0.8%	3.8%

During the year

- maximum balance (£bn)	157	78	37	57	329	357	594
- average balance (£bn)	137	62	34	50	283	292	486
- weighted average interest rate	0.6%	0.8 %	0.9%	1.0%	0.7%	1.9%	4.2%

Notes:
(1) Excludes derivative cash collateral of £28 billion at 31 December 2010 (2009 - £33 billion; 2008 - £46 billion), 2010 average of £34 billion (2009 - £40 billion; 2008 - £20 billion).
(2) Excludes Federal Home Loans Banks long-term borrowings of £1.5 billion at 31 December 2010 (2009 - £2.7 billion; 2008 - £3.9 billion), 2010 average of £2.3 billion (2009 - £3.1 billion; 2008 - £3.0 billion).

Balances are generally based on monthly data. Average interest rates during the year are computed by dividing total interest expense by the average amount borrowed. Average interest rates at year end are average rates for a single day and as such may reflect one-day market distortions which may not be indicative of generally prevailing rates.

* unaudited

Balance sheet management: Funding and liquidity risk continued

Balance sheet management: Interest rate risk

The table below shows debt securities issued by the Group with an original maturity of one year or more. The Group also executes other long-term funding arrangements (predominately term repurchase agreements) not reflected in the tables below.

	2010 £m	2009 £m	2008 £m
Public			
- unsecured	12,887	8,386	5,166
- unsecured: guaranteed	—	19,663	6,334
- secured	8,041	—	—
Private			
- unsecured	17,450	14,895	24,172
- unsecured: guaranteed	—	15,459	8,151
Gross issuance	38,378	58,403	43,823

The table below shows the original maturity and currency breakdown of long-term debt securities issued in 2010.

Original maturity	£m	%
1-2 years	1,698	4.4
2-3 years	3,772	9.8
3-4 years	5,910	15.4
4-5 years	559	1.5
5-10 years	14,187	37.0
> 10 years	12,252	31.9
	38,378	100.0

Currency	£m	%
GBP	4,107	10.7
EUR	19,638	51.2
USD	9,760	25.4
Other	4,873	12.7
	38,378	100.0

Key points

- Term debt issuances exceeded the Group's original plans of £20 - £25 billion as investor appetite for both secured and unsecured funding allowed the Group to accelerate plans to extend the maturity profile of its wholesale funding.
- Execution was strong across G10 currencies and diversified across the yield curve.
- There were term issuances of £4.5 billion in January and February 2011.

Balance sheet management: Funding and liquidity risk continued

Credit Guarantee Scheme

The table below shows the residual maturity of the Group's outstanding term funding issued under the UK Government's Credit Guarantee Scheme at 31 December 2010.

Residual maturity	£m	%
Q1 2011	196	0.5
Q2 2011	1,224	2.9
Q4 2011	18,728	45.2
Q1 2012	15,593	37.6
Q2 2012	5,714	13.8
	41,455	100.0

Key points

- The Group had £41.5 billion outstanding at 31 December 2010 (2009 - £45.2 billion) of which £20.1 billion matures in 2011.
- The Group's funding plan for 2011 incorporates these maturities along with other structural balance sheet changes.

Special Liquidity Scheme*

The Group does not use the Special Liquidity Scheme (SLS) to fund its business activities. The Group's outstanding liabilities under the SLS are used to fund elements of its liquidity portfolio. Balances under the SLS continued to reduce in 2010.

Liquidity portfolio

The table below shows the composition of the Group's liquidity portfolio. The Group has refined the presentation of this portfolio. Treasury bills and other government bonds which were previously reported under the central Group Treasury portfolio, as well as unencumbered collateral and other liquid assets are now included in their respective asset classes.

	2010	2009
Liquidity portfolio	£m	£m
Cash and balances at central banks	53,661	51,500
Treasury bills	14,529	30,010
Central and local government bonds (1)		
- AAA rated governments (2)	41,435	30,140
- AA- to AA+ rated governments	3,744	2,011
- governments rated below AA	1,029	1,630
- local government	5,672	5,706
	51,880	39,487
Unencumbered collateral (3)		
- AAA rated	17,836	20,246
- below AAA rated and other high quality assets	16,693	29,418
	34,529	49,664
Total liquidity portfolio	154,599	170,661

Notes:

(1) Includes FSA eligible government bonds of £34.7 billion at 31 December 2010.

(2) Includes AAA rated US government guaranteed agencies.

(3) Includes secured assets which are eligible for discounting at central banks, comprising loans and advances and debt securities.

Key points

- The liquidity portfolio at the end of 2009 reflects the build up of liquid assets ahead of the legal separation of RBS N.V. and ABN AMRO in April 2010. Following the separation, the liquid assets and associated short-term wholesale funding were managed down to business as usual levels.

  - The Group has maintained its liquidity portfolio at or near its strategic target of £150 billion. The final level of the reserves will be influenced by balance sheet size, maturity profile and regulatory requirements.

- The Group anticipates that the composition of the liquidity portfolio will vary over time based on changing regulatory requirements and internal evaluation of liquidity needs under stress.

* unaudited

Balance sheet management: Funding and liquidity risk continued

Funding and liquidity metrics

The Group continues to improve and augment funding and liquidity risk management practices in light of market experience and emerging regulatory and industry standards. The Group monitors a range of funding and liquidity indicators for the consolidated Group as well as its principal subsidiaries. These metrics encompass short and long-term liquidity requirements under stress and normal operating conditions. Two important structural ratios are described below.

Net stable funding ratio*

The table below shows the Group's net stable funding ratio (NSFR) estimated by applying the Basel III guidance issued in December 2010. This measure seeks to show the proportion of structural term assets which are funded by stable funding including customer deposits, long-term wholesale funding, and equity.

	2010		2009		2008		
		ASF(1)		ASF(1)		ASF(1)	Weighting
	£bn	£bn	£bn	£bn	£bn	£bn	%
Equity	76	76	80	80	64	64	100
Wholesale funding > 1 year	154	154	144	144	149	149	100
Wholesale funding < 1 year	157	—	250	—	343	—	—
Derivatives	424	—	422	—	969	—	—
Repurchase agreements	115	—	106	—	142	—	—
Deposits							
- Retail and SME - more stable	172	155	166	149	184	166	90
- Retail and SME - less stable	51	41	50	40	55	44	80
- Other	206	103	199	99	221	110	50
Other (2)	98	—	105	—	92	—	—
Total liabilities and equity	1,453	529	1,522	512	2,219	533	
Cash	57	—	52	—	12	—	—
Inter-bank lending	58	—	49	—	71	—	—
Debt securities:							
- < 1year	43	—	69	—	69	—	—
- central and local governments AAA to AA- > 1 year	89	4	84	4	68	3	5
- other eligible bonds > 1 year	75	15	87	17	101	20	20
- other bonds > 1 year	10	10	9	9	15	15	100
Derivatives	427	—	438	—	991	—	—
Reverse repurchase agreements	95	—	76	—	98	—	—
Customer loans and advances							
- < 1 year	125	63	153	77	190	95	50
- residential mortgages > 1 year	145	94	137	89	170	111	65
- retail loans < 1year	22	19	24	20	30	25	85
- other > 1year	211	211	241	241	298	298	100

Other (3)	96	96	103	103	106	107	100
Total assets	1,453	512	1,522	560	2,219	674	
Undrawn commitments	267	13	289	14	347	17	5
Total assets and undrawn commitments	1,720	525	1,811	574	2,566	691	
Net stable funding ratio		101%		89%		77%	

Notes:

(1) Available stable funding.

(2) Deferred tax, insurance liabilities and other liabilities.

(3) Prepayments, accrued income, deferred tax and other assets.

(4) Prior periods have been revised to reflect the Basel III guidance.

Key points*

- The Group's estimated NSFR improved to 101% at 31 December 2010 from 89% at 31 December 2009, primarily due to a decrease in wholesale funding with maturity of less than one year and a reduction in customer loans.

- The Group's NSFR calculation will continue to be refined over time in line with regulatory developments.

* unaudited

Balance sheet management: Funding and liquidity risk continued
Funding and liquidity metrics continued
The table below shows the Group's loan to deposit ratio and customer funding gap.

	Loan to deposit ratio (1)		Customer funding gap (1)
	Group	Core	Group
	%	%	£bn
2010	117	96	74
2009	135	104	142
2008	151	118	233

Note:
(1) Excludes repurchase agreements, bancassurance deposits to 31 March 2010 and loans are net of provisions. For Group before RFS MI only.

Key points
- The Group's loan to deposit ratio improved significantly by 1800 basis points to 117% at 31 December 2010 and the funding gap narrowed by £68 billion over the year to £74 billion at 31 December 2010, due primarily to a reduction in Non-Core customer loans and increased customer deposits.

- The loan to deposit ratio for the Group's Core business at 31 December 2010 improved to 96% from 104% at 31 December 2009.

- It is a strategic objective to improve the Group's loan to deposit ratio to 100%, or better, by 2013.

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

	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
2010	£m	£m	£m	£m	£m	£m
Assets by contractual maturity						
Cash and balances at central banks	56,988	—	—	1	—	25
Loans and advances to banks	33,809	1,377	711	120	193	79
Debt securities	11,247	9,816	25,059	22,400	40,600	22,128
Settlement balances	11,334	231	—	—	41	—
Other financial assets	458	221	207	15	405	—
Total maturing assets	113,836	11,645	25,977	22,536	41,239	22,232
Loans and advances to customers	112,465	86,592	120,139	69,304	78,131	63,015
Derivatives held for hedging	530	1,588	2,612	638	210	101
	226,831	99,825	148,728	92,478	119,580	85,348

Liabilities by contractual maturity						
Deposits by banks	43,396	4,417	1,243	304	651	374
Debt securities in issue	89,583	43,032	31,862	22,569	24,209	6,697
Subordinated liabilities	2,485	2,611	6,570	8,691	8,672	4,607
Settlement balances and other liabilities	12,423	59	136	177	385	25
Total maturing liabilities	147,887	50,119	39,811	31,741	33,917	11,703
Customer accounts	402,457	18,580	8,360	4,651	4,393	2,384
Derivatives held for hedging	608	936	2,103	969	681	253
	550,952	69,635	50,274	37,361	38,991	14,340
Maturity gap	(34,051)	(38,474)	(13,834)	(9,205)	7,322	10,529
Cumulative maturity gap	(34,051)	(72,525)	(86,359)	(95,564)	(88,242)	(77,713)
Guarantees and commitments notional amount						
Guarantees (1)	31,026	—	—	—	—	—
Commitments (2)	266,822	—	—	—	—	—

For notes to this table refer to page 82.

Balance sheet management: Funding and liquidity risk continued
Assets and liabilities by contractual cashflow maturity continued

2009	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	52,239	—	—	1	25	—
Loans and advances to banks	42,615	1,757	966	282	868	71
Debt securities	17,581	14,484	29,675	26,788	52,104	30,335
Settlement balances	12,020	6	1	—	8	1
Other financial assets	265	215	402	127	421	—
Total maturing assets	124,720	16,462	31,044	27,198	53,426	30,407
Loans and advances to customers	126,238	65,946	130,323	101,984	180,595	202,809
Derivatives held for hedging	488	1,547	3,049	1,076	751	10
	251,446	83,955	164,416	130,258	234,772	233,226
Liabilities by contractual maturity						
Deposits by banks	65,966	15,541	3,934	2,301	632	12
Debt securities in issue	100,220	49,300	56,869	25,915	27,326	3,819
Subordinated liabilities	1,929	1,892	3,654	4,963	20,157	6,105
Settlement balances and other liabilities	12,048	100	139	104	239	83
Total maturing liabilities	180,163	66,833	64,596	33,283	48,354	10,019
Customer accounts	521,400	15,619	5,944	4,221	8,490	4,392
Derivatives held for hedging	660	1,566	3,232	1,264	1,674	1,508
	702,223	84,018	73,772	38,768	58,518	15,919
Maturity gap	(55,443)	(50,371)	(33,552)	(6,085)	5,072	20,388
Cumulative maturity gap	(55,443)	(105,814)	(139,366)	(145,451)	(140,379)	(119,991)
Guarantees and commitments notional amount						
Guarantees (1)	39,952	—	—	—	—	—
Commitments (2)	291,634	—	—	—	—	—

For notes to this table refer to page 82.

Balance sheet management: Funding and liquidity risk continued
Assets and liabilities by contractual cashflow maturity continued

2008	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	12,333	25	—	—	2	29
Loans and advances to banks	61,630	19,369	2,673	921	111	70
Debt securities	26,006	12,895	24,629	23,927	57,846	24,535
Settlement balances	17,830	—	—	—	2	—
Other financial assets	621	193	58	111	343	—
Total maturing assets	118,420	32,482	27,360	24,959	58,304	24,634
Loans and advances to customers	195,553	81,054	138,378	125,621	160,271	152,084
Derivatives held for hedging	266	1,796	2,281	1,359	1,517	649
	314,239	115,332	168,019	151,939	220,092	177,367
Liabilities by contractual maturity						
Deposits by banks	154,614	14,347	3,345	2,754	2,048	34
Debt securities in issue	131,714	48,652	40,067	38,223	38,667	5,626
Subordinated liabilities	1,753	4,271	6,824	5,793	24,503	13,030
Settlement balances and other liabilities	13,351	5	12	6	10	6
Total maturing liabilities	301,432	67,275	50,248	46,776	65,228	18,696
Customer accounts	523,268	33,450	6,577	6,337	7,298	5,319
Derivatives held for hedging	394	2,216	2,543	1,334	2,682	1,373
	825,094	102,941	59,368	54,447	75,208	25,388
Maturity gap	(183,012)	(34,793)	(22,888)	(21,817)	(6,924)	5,938
Cumulative maturity gap	(183,012)	(217,805)	(240,693)	(262,510)	(269,434)	(263,496)

Notes:
(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
(2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above have been prepared on the following basis:

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

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

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

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

Held-for-trading assets and liabilities amounting to £665 billion (assets) and £586 billion (liabilities) (2009 - £651 billion assets, £568 billion liabilities; 2008 - £1,227 billion assets, £1,147 billion liabilities) have been excluded from the table in view of their short-term nature.

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

The Group provides financial products to satisfy a variety of customer requirements. Loans and deposits are designed to meet customer objectives with regard to repricing frequency, tenor, index, prepayment, optionality and other features. These characteristics are aggregated to form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates. Mismatches in these sensitivities give rise to net interest income (NII) volatility as the level of interest rates rise and fall. For example, a bank with a floating rate loan portfolio and largely fixed rate deposits will see its NII rise as interest rates rise and fall as rates decline. Due to the long-term nature of many banking book portfolios, layered repricing characteristics and maturities, it is likely the NII will vary from period to period even with no change in market rate level. New business volumes originated in any period will alter the interest rate sensitivity of a bank if it differs from portfolios originated in prior periods.

Interest rate risk in the banking book (IRRBB) is assessed using a set of standards to define, measure and report the market risk. It is the Group's policy to minimise interest rate sensitivity in banking book portfolios and where interest rate risk is retained to ensure that appropriate measures and limits are applied. Key conventions in evaluating IRRBB are subjected to approval of divisional ALCOs and GALCO. Limits on IRRBB are proposed by the Group Treasurer for approval by ERF annually. IRRBB is measured using a version of the same VaR methodology that is used for the Group's trading portfolios. Net interest income exposures are measured in terms of sensitivity over time to movements in interest rates. Additionally, Citizens measures the sensitivity of the market value of equity to changes in forward interest rates.

Divisions with the exception of Citizens and GBM are required to manage banking book exposures through internal transactions with Group Treasury to the greatest extent possible. Residual risks in divisions must be measured and reported as described.

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

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

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

	Average	Period end	Maximum	Minimum
	£m	£m	£m	£m
2010	57.5	96.2	96.2	30.0
2009	85.5	101.3	123.2	53.3
2008	130.0	76.7	197.4	76.7

A breakdown of the Group's IRRBB VaR by currency is shown below.

Currency	2010 £m	2009 £m	2008 £m
EUR	32.7	32.2	30.9
GBP	79.3	111.2	26.0
USD	120.6	42.1	57.9
Other	9.7	9.0	14.0

Key points

- Interest rate exposure at 31 December 2010 was slightly lower than at the end of 2009. The average exposure in 2010 was 33% below the average for 2009.

- In general, actions taken throughout 2010 to mitigate earnings sensitivity from interest rate movements were executed in US dollars, hence the year on year shift in VaR by currency.

Balance sheet management: Sensitivity of net interest income*

The Group seeks to mitigate the effect of prospective interest rate movements which could reduce future net interest income through the movement of market rates in the Group's retail and commercial businesses, whilst balancing the cost of such hedging activities on the current net revenue stream. Hedging activities also consider the impact on market value sensitivity under stress.

The following table shows the sensitivity of net interest income over the next twelve months to an immediate up and down 100 basis points change to all interest rates. In addition the table includes a 100 basis points steepening and flattening of the yield curves over a one year horizon.

	2010 £m	2009 £m	2008 £m
+100bp shift in yield curves	232	510	139
- 100bp shift in yield curves	(352)	(687)	(234)
Steepener	(30)		
Flattener	(22)		

Key points

- The Group executed transactions in 2010 to reduce the exposure to rising rates related to capital raised in December 2009.

- Actions taken during the year increased the current base level of net interest income, while reducing the Group's overall asset sensitivity.

Structural foreign currency exposures

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

The Group seeks to limit the sensitivity to its Core Tier 1 ratio to 20 basis points in a 10% rate shock scenario. The Group's structural foreign exchange position is reviewed by GALCO regularly.

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

2010	Net assets of overseas operations £m	RFS Holdings minority interest £m	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures pre-economic hedges £m	Economic hedges (1) £m	Residual structural foreign currency exposures £m
US dollar	17,137	2	17,135	(1,820)	15,315	(4,058)	11,257
Euro	8,443	33	8,410	(578)	7,832	(2,305)	5,527
Other non-sterling	5,320	244	5,076	(4,135)	941	—	941
	30,900	279	30,621	(6,533)	24,088	(6,363)	17,725

2009							
US dollar	15,589	(2)	15,591	(3,846)	11,745	(5,696)	6,049
Euro	21,900	13,938	7,962	(2,351)	5,611	(3,522)	2,089
Other non-sterling	5,706	511	5,195	(4,001)	1,194	—	1,194
	43,195	14,447	28,748	(10,198)	18,550	(9,218)	9,332
2008							
US dollar	17,480	(19)	17,499	(3,659)	13,840	(7,806)	6,034
Euro	26,943	15,431	11,512	(7,461)	4,051	(4,109)	(58)
Chinese Renminbi	3,928	1,898	2,030	(1,082)	948	—	948
Brazilian Real	5,088	621	4,467	(3,096)	1,371	—	1,371
	53,439	17,931	35,508	(15,298)	20,210	(11,915)	8,295

Note:

(1) The economic hedges represent US dollar and euro preference shares in issue that are treated as equity under IFRS, and do not qualify as hedges for accounting purposes.

Key points

- Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. A 5% strengthening in foreign currencies against sterling would result in a gain of £1,200 million (2009 - £930 million; 2008 - £1,010 million) recognised in equity, while a 5% weakening in foreign currencies would result in a loss of £1,150 million (2009 - £880 million; 2008 - £960 million) recognised in equity.

- Structural foreign currency exposures have increased in sterling terms due to exchange rate movements and reduced hedging. The increased exposures more effectively offset retranslation movements in RWAs, reducing the sensitivity of the Group's capital ratios to exchange rate movements.

* unaudited

Balance sheet management: Equity risk

The Group holds equity positions in order to achieve strategic objectives, support venture capital transactions or in respect of customer restructuring arrangements. The Group is exposed to market risk on these banking book equity positions because they are measured at fair value. Fair values are based on available market prices wherever possible. In the event that market prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The table below sets out the Group's banking book equity positions.

	Listed	Unlisted	Total
2010	£m	£m	£m
Group	535	2,080	2,615
2009			
Group before RFS MI	401	2,388	2,789
RFS MI	60	211	271
Group	461	2,599	3,060
2008			
Group before RFS MI	4,211	2,759	6,970
RFS MI	56	259	315
Group	4,267	3,018	7,285

Note:
(1) The table above excludes equity exposures held-for-trading and those held by insurance/assurance entities.

Outlook for 2011*

Whilst there have been improvements in the state of the global economy over the course of 2010, the outlook for 2011 remains uncertain. In line with meeting the objectives of the strategic plan, the Group is actively focusing on closing the customer funding gap, continuing to exit Non-Core businesses and reducing undrawn and contingent commitments. These actions will result in a reduction in the need for short-term wholesale funding; the Group is targeting £150 billion by 2013 compared with £157 billion at the end of 2010. The Group will continue to reduce reliance on government supported schemes and be governed by the state of the markets and economies in which it operates. These strategies are aimed at insuring that the Group is more resilient to any further disruptions in the market and better placed to take advantage of favourable trading conditions as they return.

* unaudited

Risk management: Credit risk

All the disclosures in this section (pages 86 to 105) are audited unless otherwise indicated by an asterisk (*).

Credit risk is the risk of financial loss owing to the failure of customers or counterparties to meet payment obligations. The quantum and nature of credit risk assumed across the Group's different businesses varies considerably, while the overall credit risk outcome usually exhibits a high degree of correlation to the macroeconomic environment.

Credit risk organisation

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

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

GCR is additionally responsible for verifying compliance by the divisions with all Group credit policies. It is assisted in this by a credit quality assurance function owned by the Group Chief Credit Officer and housed within the divisions.

Credit risk appetite

Credit risk appetite is managed and controlled through a series of frameworks designed to limit concentration by sector, counterparty, country or asset class. These are supported by a suite of Group-wide and divisional policies setting out the risk parameters within which business units may operate. Information on the Group’s credit portfolios is reported to the Board via the divisional and Group level risk committees detailed in the Governance section on page 60.

Product/asset class

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

- Wholesale: formal policies, specialised tools and expertise, tailored monitoring and reporting and in certain cases specific limits and thresholds are deployed to address certain lines of business across the Group where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. Such portfolios are subject to formal governance, including periodic review, at either Group or divisional level, depending on materiality.

Sector

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

Single name

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

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

Risk management: Credit risk continued
Credit risk appetite continued

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

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

Single name concentrations
Reducing the risk arising from concentrations to single names remains a key focus of management attention. Notwithstanding continued market illiquidity and the impact of negative credit migration caused by the current economic environment, significant progress was made in 2010 and credit exposures in excess of single name concentration limits fell by over 40% during the year.

Country
Country risk arises from sovereign events (default or restructuring); economic events (contagion of sovereign default to other parts of the economy, cyclical economic shock); political events (convertibility restrictions and expropriation or nationalisation); and natural disaster or conflict. Such events have the potential to impact elements of the Group's credit portfolio that are directly or indirectly linked to the affected country and can also give rise to market, liquidity, operational and franchise risk related losses.

The framework for the Group's appetite for country risk is set by the Executive Risk Forum (ERF) in the form of limits by country risk grade, with sub-limits on medium-term exposure. Authority is delegated to the Group Country Risk Committee to manage exposures within the framework, with escalation where needed to ERF. Specific limits are set for individual countries based on a risk assessment taking into account the Group's franchise and business mix in that country. Additional limitations (for example, on foreign-currency exposure and product types with higher potential for loss in case of country events) may be established to address specific vulnerabilities in the context of a country's outlook and/or the Group's business strategy in a particular country. A country watch list framework is in place to proactively monitor emerging issues and facilitate the development of mitigation strategies.

Global Restructuring Group
The Global Restructuring Group (GRG) manages problem and potential problem exposures in the Group's wholesale credit portfolios. Its primary
function is to actively manage the exposures to minimise loss for the Group and, where feasible, to return the exposure to the Group's mainstream loan book.

Originating business units consult with GRG prior to transfer to GRG when a potentially negative event or trend emerges which might affect a customer's ability to service its debt or increase the Group's risk exposure to that customer. Such circumstances include deteriorating trading performance, likely breach of covenant, challenging macroeconomic conditions, a missed payment or the expectation of a missed payment to the Group or another creditor.

On transfer of the relationship, GRG devises a bespoke strategy that optimises recoveries from the debt. This strategy may also involve GRG reviewing the business operations and performance of the customer. A number of alternative approaches will typically be considered including:

- Covenant relief: the temporary waiver or recalibration of covenants may be granted to mitigate a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan.

- Amendment of restrictive covenants: restrictions in loan documents may be amended or waived as part of an overall remedial strategy to allow: additional indebtedness; the granting of collateral; the sale of a business; the granting of junior lien on the collateral; or other fundamental change in capital or operating structure of the enterprise.

- Variation in margin: contractual margin may be amended to bolster the customer's day-to-day liquidity, with the aim of helping to sustain the customer's business as a going concern. This would normally be accompanied by the Group receiving an exit payment, payment in kind or deferred fee.

- Payment holidays and loan rescheduling: payment holidays or changes to the contracted amortisation profile including extensions in contracted maturity or roll-overs may be granted to improve customer liquidity. Such concessions often depend on the expectation that liquidity will recover when market conditions improve or from capital raising initiatives that access alternative sources of liquidity. Recently, these types of concessions have become more common in commercial real estate transactions in situations when a shortage of market liquidity rules out immediate refinancing and short-term forced collateral sales unattractive.

- Forgiveness of all or part of the outstanding debt: debt may be forgiven or exchanged for equity where a fundamental shift in the customer's business or economic environment means that other forms of restructuring strategies are unlikely to succeed in isolation and the customer is incapable of servicing current debt obligations. Debt forgiveness is often an element in leveraged finance transactions which are typically structured on the basis of projected cash flows from operational activities rather than underlying tangible asset values. Maintaining the business as a going concern with a sustainable level of debt is the preferred option rather than realising the underlying assets, provided that the underlying business model and strategy are considered viable.

Risk management: Credit risk continued
Global Restructuring Group continued
Depending on the case in question, GRG may employ a combination of these options in order to achieve the best outcome. It may also consider alternative approaches, either alone or together with the options listed above.

The following are generally considered as options of last resort:

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

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

As discussed above, GRG will consider a range of possible restructuring strategies. At the time of execution, the ultimate outcome of the strategy adopted is unknown and highly dependent on the cooperation of the borrower and the continued existence of a viable business. The customer's financial position, its anticipated future prospects and the likely effect of the restructuring including any concessions are considered by the GRG relationship manager to establish whether an impairment provision is required, subject to divisional and Group governance.

During 2010, GRG completed corporate loan restructurings totalling £6.2 billion (exposures of more than £5 million) of which £2.7 billion were classified as impaired. Of these restructurings £2.4 billion related to commercial real estate and £2.1 billion to manufacturing. The incidence of the main types of arrangements is analysed below:

	% of loans (by value)
Term extensions	54
Debt forgiveness	25
Debt for equity	23
Interest rate concessions and payment moratoriums	36

The total above exceeds 100% as an individual case can involve more than one type of arrangement.

Transfer of restructured loans to the performing book follows assessment by relationship managers in GRG. All cases are individually assessed; when no further losses are expected the loan is returned to performing status. Restructured loans that carry an impairment provision remain classified as impaired. Of the £3.5 billion of corporate loans that were transferred to the performing book with a concession during 2010, loans amounting to £1.8 billion had a negotiated margin increase as compensation for concessions granted.

Retail collections and recoveries
There are collections and recoveries functions in each of the consumer businesses. Their role is to provide support and assistance to customers who are currently experiencing difficulties in meeting their financial obligations. Where possible, the aim of the collections and recoveries teams is to return the customer to a satisfactory position, by working with them to restructure their finances. If this is not possible, the team has the objective of reducing the loss

to the Group.

Forbearance*

The Group’s retail forbearance activities involve granting various contract revisions not normally available, such as reduced repayments, payment moratoriums and the roll up of arrears, principally to retail customers with secured lending that are experiencing temporary financial difficulties.

Loans are identified for forbearance primarily as a result of contact from the customer or payment arrears and it is only granted following an assessment of the customer’s ability to pay. For those loans that are classified as impaired, the Group’s objective is to minimise the loss on these accounts; for currently performing loans the aim is to enable the customer to continue to service the loan.

Forbearance lending for which an impairment loss provision has been recognised remains classified as non-performing. Where the customer met the loan terms prior to modification and where there is an expectation that the customer will meet the revised terms, these loans are classified as performing loans.

Retail loan forbearance arrangements during 2010 totalled £3.3 billion (residential mortgages £3.1 billion), of which £1.0 billion were classified as impaired. The incidence of the main types of retail forbearance is analysed below.

	% of loans (by value)
Reduced repayments	59
Payment moratoriums	20
Roll up of arrears	19
Interest reductions	6
Term extensions	3

The total exceeds 100% as an individual case can involve more than one type of arrangement.

Of the forbearance arrangements agreed in the performing book during 2010, less than 15% were impaired as at 31 December 2010.

* unaudited

Risk management: Credit risk continued

Credit risk mitigation*

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

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the Group cover: general requirements, including acceptable credit risk mitigation types and any conditions or restrictions applicable to those mitigants; the means by which legal certainty is to be established, including required documentation and all necessary steps required to establish legal rights; acceptable methodologies for the initial and any subsequent valuations of collateral and the frequency with which they are to be revalued (for example, daily in the trading book); actions to be taken in the event the current value of mitigation falls below required levels; management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation; management of concentration risks, for example, setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

Credit risk measurement

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

Probability of default/customer credit grade (PD)

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

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

Retail businesses: each customer account is separately scored using models based on the most material drivers of default. In general, scorecards are statistically derived using customer data. Customers are assigned a score, which in turn is mapped to a probability of default. The probabilities of default are used to group customers into risk pools. Pools are then assigned a weighted average probability of default using regulatory default definitions.

Exposure at default

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

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

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

* unaudited

Risk management: Credit risk continued
Credit risk assets*

Credit risk assets consist of:

- Lending: cash and balances at central banks and loans and advances to banks and customers (including overdraft facilities, instalment credit and finance leases);
- Rate risk management (RRM); and
- Contingent obligations, primarily letters of credit and guarantees.

Reverse repurchase agreements and issuer risk (primarily debt securities - see page 116) are excluded. Where relevant, and unless otherwise stated, the data reflects the effect of credit mitigation techniques.

Divisional analysis	2010 £m	2009 £m
UK Retail	108,302	103,029
UK Corporate	105,886	110,009
Wealth	18,875	16,553
Global Transaction Services	35,462	32,428
Ulster Bank	40,750	42,042
US Retail & Commercial	51,699	52,104
Retail & Commercial	360,974	356,165
Global Banking & Markets	171,891	205,588
Other	36,659	3,305
Core	569,524	565,058
Non-Core	125,383	158,499
	694,907	723,557

Key points

- All Core divisions either broadly maintained or reduced credit risk assets over the period. The exception, ‘Other’, is driven by exposures in Group Treasury. Growth here has occurred within the highest asset quality bands reflecting exposure to central banks in US, UK and Germany.
- Non-Core exposure reduced in line with targets during 2010 as a result of disposals and active run-down of assets. Key reductions include the country exits in Asia & Latin America, material reductions in the Leveraged Finance business through asset sales and restructurings and unwinding of trades within the Markets business.

Credit risk assets: Asset quality*
Using the PD models described previously, customers are assigned credit grades and scores, which are used for internal management reporting across portfolios, including a Group level asset quality scale, as shown below.

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 Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be readily aggregated and reported at increasing levels of granularity depending on stakeholder or business need.

		2010				2009			
Asset quality		Core	Non-Core	Total	%	Core	Non-Core	Total	%
band	PD range	£m	£m	£m	of total	£m	£m	£m	of total
AQ1	0% - 0.034%	175,793	17,728	193,521	27.8	149,132	23,226	172,358	23.8
AQ2	0.034% - 0.048%	18,274	2,526	20,800	3.0	18,029	3,187	21,216	2.9
AQ3	0.048% - 0.095%	26,244	4,259	30,503	4.4	26,703	7,613	34,316	4.7
AQ4	0.095% - 0.381%	64,277	15,052	79,329	11.4	78,144	18,154	96,298	13.3
AQ5	0.381% - 1.076%	90,639	18,767	109,406	15.7	92,908	24,977	117,885	16.3
AQ6	1.076% - 2.153%	73,367	12,913	86,280	12.4	76,206	18,072	94,278	13.0
AQ7	2.153% - 6.089%	41,399	10,451	51,850	7.5	44,643	15,732	60,375	8.3
AQ8	6.089% - 17.222%	15,300	4,308	19,608	2.8	18,923	4,834	23,757	3.4
AQ9	17.222% - 100%	11,398	8,621	20,019	2.9	11,589	8,074	19,663	2.7
AQ10	100%	18,003	25,005	43,008	6.2	16,756	22,666	39,422	5.5
Other (1)		34,830	5,753	40,583	5.9	32,025	11,964	43,989	6.1
		569,524	125,383	694,907	100.0	565,058	158,499	723,557	100.0

Note:

(1) 'Other' largely comprises assets covered by the standardised approach for which a PD equivalent to those assigned to assets covered by the internal ratings based approach is not available.

*unaudited

Risk management: Credit risk continued
Credit risk assets: Asset quality* continued

	2010		2009	
AQ10 credit risk assets	AQ10 £m	% of divisional credit risk assets	AQ10 £m	% of divisional credit risk assets
UK Retail	5,017	4.6	4,846	4.7
UK Corporate	5,130	4.8	5,604	5.1
Wealth	9	—	11	0.1
Global Transaction Services	349	1.0	242	0.7
Ulster Bank	4,348	10.7	2,741	6.5
US Retail & Commercial	599	1.2	506	1.0
Retail & Commercial	15,452	4.3	13,950	3.9
Global Banking & Markets	2,551	1.5	2,806	1.4
Core	18,003	3.2	16,756	3.0
Non-Core	25,005	19.9	22,666	14.3
	43,008	6.2	39,422	5.5

The table below provides a breakdown of AQ10 credit risk assets by sector.

AQ10 credit risk assets	2010 £m	2009 £m
Personal	7,620	6,955
Property	23,672	20,145
Banks and financial institutions	1,981	1,928
Transport and storage	1,689	1,026
Other	8,046	9,368
	43,008	39,422

Key points

- The Core divisions have generally seen an improvement in asset quality within the performing book during 2010 as the economic environment has slowly improved.

- A notable exception is Ulster Bank where weakness in the Irish property sector continues to impact portfolio trends and the stock of defaulted assets (AQ10) continues to grow. Refer to section on Ulster Bank on pages 101 to 105 for more details.

- Non-Core exposure has reduced across all AQ bands with the exception of AQ10, where the transfer of additional property assets from Ulster Bank and defaults within the property sector in Ireland and globally have led to an increase over 2009. Credit migration for the remaining Non-Core portfolio has been neutral since the end of the first quarter of 2010.

- There have been no major changes in the specific sectors contributing to AQ10 band with property (55%) remaining the dominant contributor.

* unaudited

Risk management: Credit risk continued
Credit risk assets* continued

Country risk
Under the Group's country risk framework, country exposures are actively managed both for countries that represent a larger concentration and for those which, under the country watch list process, have been identified as exhibiting signs of actual or potential stress.

The country risk tables below show credit risk assets exceeding £1 billion by borrowers domiciled in countries with an external rating of A+ and below from Standard & Poor's, Moody's or Fitch and selected eurozone countries. The numbers are stated gross of mitigating action which may have been taken to reduce or eliminate exposure to country risk events.

	Lending								
2010	Central and local government £m	Central bank £m	Other financial institutions £m	Corporate £m	Personal £m	Total £m	Core £m	Non-Core £m	RRM and contingent obligations £m
Republic of Ireland	61	2,119	900	19,881	20,228	43,189	32,431	10,758	3,496
Italy	45	78	1,086	2,483	27	3,719	1,817	1,902	2,312
India	262	—	1,614	2,590	273	4,739	4,085	654	1,249
China	17	298	1,240	753	64	2,372	2,136	236	1,572
Turkey	282	68	485	1,365	12	2,212	1,520	692	547
South Korea	—	276	1,039	555	2	1,872	1,822	50	643
Russia	—	110	251	1,181	58	1,600	1,475	125	216
Mexico	—	8	149	999	1	1,157	854	303	148
Brazil	—	—	825	315	5	1,145	1,025	120	120
Romania	36	178	42	426	446	1,128	7	1,121	142
Poland	—	168	13	655	6	842	736	106	381
Portugal	86	—	63	611	6	766	450	316	537
Additional selected eurozone countries									
Spain	19	5	258	6,962	407	7,651	3,130	4,521	2,447
Greece	14	36	49	188	16	303	173	130	214
2009									
Republic of Ireland	78	1,830	1,693	21,518	22,348	47,467	32,479	14,988	4,820
Italy	10	119	751	4,465	27	5,372	1,877	3,495	2,146
India	—	109	499	2,752	63	3,423	3,240	183	1,691
China	50	296	780	947	42	2,115	1,845	270	425
Turkey	255	335	207	1,870	10	2,677	1,918	759	274
South Korea	—	6	903	656	1	1,566	1,467	99	1,458

Russia	—	58	84	1,578	27	1,747	1,275	472	511
Mexico	2	45	161	1,262	1	1,471	594	877	112
Brazil	—	—	623	420	3	1,046	833	213	282
Romania	49	392	46	637	507	1,631	37	1,594	169
Poland	—	22	40	1,038	6	1,106	996	110	625
Portugal	—	—	51	861	5	917	582	335	461
Additional selected eurozone countries									
Spain	30	17	373	7,658	438	8,516	2,957	5,559	2,325
Greece	21	37	52	290	16	416	245	171	194

*unaudited

Risk management: Credit risk continued
Credit risk assets* continued

Key points

- Credit risk assets relating to most of the countries above declined in 2010, reflecting active exposure management. In addition to the overall exposure reductions, granular portfolio reviews have been and continue to be undertaken with a view to adjusting the tenor profile and better alignment of the Group's country risk appetite to the risk of adverse economic and political developments.

- Reductions were seen in corporate and personal exposures, particularly in the Non-Core portfolios. This contrasted with increases in financial institutions in a number of countries, mostly due to increases in RRM exposure. Some countries in Asia have seen increased exposures during 2010, including two of the Group's strategically important countries in this region, China and India, following reductions in 2008 and 2009.

- The Group broadened its country risk framework in 2010, to capture advanced as well as emerging market countries. Cross-country assessments were conducted to identify portfolio vulnerabilities to a number of risk scenarios, including a eurozone sovereign debt crisis. Limit controls are being applied on a risk differentiated basis and selected exposure actions have been taken. Further scenario stress testing is continuing, and covers the potential for economic and political shocks in the eurozone and in the broader global environment.

- For selected eurozone countries, the general trend in lending was lower, due in part to a depreciation of the euro against sterling by 3% over the year.

- Republic of Ireland (ROI): lending fell by £4.3 billion in 2010, resulting from reductions in personal lending by £2.1 billion, central banks and other financial institutions by £0.5 billion and corporate clients by £1.6 billion. An increase was seen in Ulster Bank's central bank exposure due to higher cash balances as part of its liquidity portfolio. The general trend in exposure remains downward. Divisional analysis is set out below:

  - Ulster Bank represents more than 95% (£32 billion) of the Group's Core lending to ROI and has seen a minimal increase of £0.64 billion in 2010, largely because of a rise of £0.3 billion in central bank placing due to increased cash holdings. Ulster Bank Core provisions at 31 December 2010 increased by 70% due to the continuing deterioration in the Irish economy.

  - Non-Core lending to ROI (£10.8 billion) declined by £4.2 billion in 2010, mainly due to a reduction in exposure to corporate and financial institutions of £3 billion during the year. In addition, customer advances in Lombard Ireland decreased by 30% during the year to £0.9 billion. Overall default levels have continued to show signs of stabilisation.

  - Global Banking & Markets (GBM) accounts for a further £0.6 billion of the Core lending exposure, largely relating to domestic and foreign owned financial institutions. In addition, overall limits to the major Irish domestic banks have halved since 31 December 2008 to £1.2 billion, with the majority representing collateralised RRM or guarantees for third-party obligations. Overall credit quality remains acceptable with a majority of the exposure to investment grade entities.

- Spain: lending fell by £0.9 billion, due to a reduction in corporate activity. During the fourth quarter, this reduction accelerated. Non-Core represents 59% of the Group's total exposure to Spain in 2010 (2009 - 65%). In the course of

2010, progress was made towards increased collateralisation of the portfolio.

- Italy: lending decreased by £1.7 billion, as a result of a net reduction in corporate lending of £2.0 billion and an increase to financial institutions of £0.3 billion. In addition, there was an increase in RRM exposure to financial institutions by £0.7 billion; the non-lending portfolio is comprised predominantly of collateralised trading activity.

- Portugal: lending decreased slightly by £0.1 billion related to reductions in corporate activity. Non-Core represents 41% of the total exposure; the structure of the exposure was enhanced through a shift to short-term and collateralised products to support the hedging needs of customers.

- Greece: lending fell by £0.1 billion, due to a reduction in corporate activity. Continuous close scrutiny of the portfolio throughout the year and divestment of selected assets have improved the overall quality of the portfolio, available-for-sale (AFS) debt securities represent the primary concentration.

- Total exposure to Egypt was £253 million at 31 December 2010, including lending of £124 million. The Group has minimal exposures to North African countries.

* unaudited

Risk management: Credit risk continued
Credit risk assets* continued

Portfolio by industry and geography
Industry analysis plays an important part in assessing the potential for concentration risk in the loan portfolio. Particular attention is given to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future.

The table below analyses credit risk assets by industry sector and geography.

Industry sector (1)

2010	UK £m	Western Europe (excl. UK) £m	North America £m	Asia Pacific £m	Latin America £m	Other (2) £m	Total £m	Core £m	Non-Core £m
Personal	124,594	22,661	34,970	1,864	126	843	185,058	174,287	10,771
Banks	6,819	39,828	5,098	11,072	1,394	2,503	66,714	65,494	1,220
Other financial institutions	17,550	14,986	14,773	4,200	8,732	1,557	61,798	47,227	14,571
Sovereign (3)	20,209	24,826	18,088	3,243	125	1,790	68,281	66,556	1,725
Property	66,015	31,501	9,857	1,992	3,090	1,758	114,213	61,385	52,828
Natural resources	6,696	7,863	9,771	3,655	1,396	4,143	33,524	24,427	9,097
Manufacturing	10,599	8,529	6,744	2,673	917	2,062	31,524	28,088	3,436
Transport (4)	13,842	8,480	5,389	6,161	2,658	6,592	43,122	27,899	15,223
Retail and leisure	24,716	6,663	5,316	1,438	1,174	945	40,252	34,100	6,152
Telecommunication, media and technology	5,495	5,764	3,283	2,187	328	786	17,843	12,076	5,767
Business services	19,364	4,536	6,238	973	1,086	381	32,578	27,985	4,593
	315,899	175,637	119,527	39,458	21,026	23,360	694,907	569,524	125,383
2009									
Personal	120,193	23,597	37,680	1,374	63	897	183,804	165,143	18,661
Banks	7,850	36,705	4,975	9,121	1,378	2,137	62,166	58,246	3,920
Other financial institutions	14,800	14,125	17,697	4,820	8,441	1,473	61,356	43,762	17,594
Sovereign (3)	18,172	27,421	4,038	3,950	414	2,217	56,212	53,595	2,617
Property	72,768	35,558	11,221	3,507	3,127	1,440	127,621	74,892	52,729
Natural resources	7,876	9,460	9,817	3,029	3,523	4,972	38,677	26,058	12,619
Manufacturing	11,197	14,875	8,718	3,695	1,306	2,633	42,424	33,400	9,024
Transport (4)	14,097	7,033	7,287	5,294	2,604	7,140	43,455	28,362	15,093
Retail and leisure	25,811	8,236	6,148	3,602	1,205	1,691	46,693	35,580	11,113
Telecommunication, media and technology	6,128	8,340	4,854	2,040	680	1,409	23,451	13,645	9,806

Business services	20,497	6,772	6,950	1,137	1,439	903	37,698	32,375	5,323
	319,389	192,122	119,385	41,569	24,180	26,912	723,557	565,058	158,499
2008									
Personal	116,870	25,802	49,182	2,918	73	1,609	196,454		
Banks	11,030	45,656	12,179	8,336	1,693	3,274	82,168		
Other financial institutions	25,266	17,481	29,125	5,836	12,892	1,979	92,579		
Sovereign (3)	4,755	8,610	3,396	9,032	459	2,837	29,089		
Property	78,689	43,777	13,530	5,092	3,750	1,608	146,446		
Natural resources	10,092	20,469	15,726	4,366	3,694	8,907	63,254		
Manufacturing	14,049	22,416	17,383	5,041	1,848	4,427	65,164		
Transport (4)	16,447	12,553	9,320	8,347	3,545	8,572	58,784		
Retail and leisure	26,143	11,047	8,060	1,655	871	1,106	48,882		
Telecommunication, media and technology	7,483	11,638	12,264	3,171	1,145	2,122	37,823		
Business services	20,191	4,863	7,895	667	266	351	34,233		
	331,015	224,312	178,060	54,461	30,236	36,792	854,876		

Notes:

(1) Based on new sector mappings which are aligned to the sector concentration framework.

(2) ‘Other’ comprises Central and Eastern Europe, Middle East, Central Asia and Africa.

(3) Sovereign includes central bank exposures.

(4) Excludes net investment in operating leases in shipping and aviation portfolios as they are accounted for as property, plant and equipment; however, operating leases are included in the monitoring and management of these portfolios.

*unaudited

Risk management: Credit risk continued
Credit risk assets* continued

Key points

- Exposure reductions occurred across most industry sectors and geographic regions.

- Modest growth in North America is attributable to the weakening of sterling against the US dollar during the period and higher short-term exposures to central banks.

- At 9.6% of total exposure, the banks sector is one of the largest in the Group, although it is geographically diversified with activities conducted in the Group's key markets across the world. Exposure is predominantly to major global banks (23% of sector exposure), defined as those with diversified domestic and international activities. The product range is diverse and includes loans and advances, treasury and capital markets products. Overall there has been a gradual downward trend in exposures to banks, but exposures have fluctuated markedly due to lines being drawn and repaid over short periods and mark to market movements associated with trading activity. Overall asset quality has stabilised in line with improving economic conditions, although the sovereign crisis affecting several eurozone countries has placed downward pressure on the asset quality of banks in these countries (11% of sector exposure).

- Exposures to the non bank financial sector are dominated by traded products and spread across a wide range of financial institutions including insurance companies, securitisations, financial intermediaries, finance companies, unleveraged and leveraged funds (including hedge funds). The majority of these are domiciled in the UK, Western Europe and US with no other material geographic or sector concentrations and business is developed selectively. Asset quality has stabilised as the economic environment has improved. Exposures to defaulted entities totalled £1.8 billion, 3% of total exposure to this sector.

- Sovereigns comprise activities with central governments, central banks and sub sovereigns such as local authorities in the Group's key markets in the UK, Western Europe and USA. The Group’s exposure to sovereigns fluctuates according to the Group's liquidity requirements and cash positions which determine the level of cash placed with sovereign entities. The asset quality of the portfolios has been impacted by the sovereign crisis in several eurozone countries and the resultant multiple downgrading of these countries.

- The Group’s exposure to the property sector totals £114 billion, a reduction of 11% in the period, of which 76% is commercial real estate (further detail on pages 96 and 97). The remainder comprises lending to property-related sectors including housing associations, estate agents and management companies. The majority of property (with the exception of Non-Core) is within the UK Corporate division (33%) and Ulster Bank (6%).

- Exposure to the manufacturing sector is concentrated in the industrial (40%), agriculture (24%) and food & consumer (21%) sub-sectors. The overall reduction in exposure of £10.9 billion is partly due to the run-off and restructuring of assets in Western Europe and in the Non-Core portfolio. Portfolio asset quality has held up well during the year but fluctuating commodity prices continue to pose a key risk to the more cyclical sub-sectors. Manufacturing exposure in default totals £1.5 billion (2009 - £3.7 billion).

- The transport sector accounts for 6% of exposure and primarily comprises loans and advances to borrowers in the shipping, automotive and aviation segments in the Core bank. Aviation Capital and a portfolio of shipping loans are held within Non-Core. Core bank exposure resides primarily in Corporate Banking and

Global Banking & Markets and the portfolio is well diversified geographically. In aggregate, the exposure within and asset quality of the Core portfolio remained stable over the year. Global economic conditions and related trends in trade flows and discretionary consumer spending continue to inform the Group’s cautious stance. Transport exposure in default totals of £1.7 billion (2009 - £1 billion).

- Whilst there have been no material impairment charges for shipping to date, the exposure that is subject to a heightened level of monitoring currently stands at approximately £2.8 billion out of a total portfolio of £13 billion, which reflects the continued difficult market conditions that have been experienced during 2010. Recent quarterly vessel valuations undertaken by external shipbrokers show that the majority of our exposures remain fully secured. Conditions will remain challenging for the foreseeable future.

* unaudited

Risk management: Credit risk continued
Credit risk assets* continued
Key credit portfolios

Commercial real estate
The definition of commercial real estate was revised during 2010 to include commercial investment properties, residential investment properties, commercial development properties and residential development properties (including house builders); 2009 data are presented on a consistent basis.

The commercial real estate lending portfolio totalled £87 billion at 31 December 2010, a 11% decrease over the prior year (2009 - £98 billion). The Non-Core portion of the portfolio totalled £46 billion (52% of the portfolio) in 2010 (2009 - £47 billion, or 48% of the portfolio) and includes exposures in Ulster Bank Group as discussed on page 105.

	2010			2009		
	Investment	Development	Total	Investment	Development	Total
By division (1)	£m	£m	£m	£m	£m	£m
Core						
UK Corporate	24,879	5,819	30,698	27,143	7,331	34,474
Ulster Bank	4,284	1,090	5,374	6,131	3,838	9,969
US Retail & Commercial	3,061	653	3,714	2,812	1,084	3,896
Global Banking & Markets	1,131	644	1,775	1,997	818	2,815
	33,355	8,206	41,561	38,083	13,071	51,154
Non-Core						
UK Corporate	7,591	3,263	10,854	7,390	3,959	11,349
Ulster Bank	3,854	8,760	12,614	2,061	6,271	8,332
US Retail & Commercial	1,202	220	1,422	1,409	431	1,840
Global Banking & Markets	20,502	417	20,919	24,638	873	25,511
	33,149	12,660	45,809	35,498	11,534	47,032
	66,504	20,866	87,370	73,581	24,605	98,186

	2010					2009				
	Investment		Development			Investment		Development		
	Commercial	Residential	Commercial	Residential	Total	Commercial	Residential	Commercial	Residential	Total
By geography (1)	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK (excluding Northern Ireland)	32,979	7,255	1,520	8,296	50,050	36,731	7,042	1,875	10,155	55,803
Island of Ireland	5,056	1,148	2,785	6,578	15,567	5,384	1,047	3,484	6,305	16,220
Western Europe	10,359	707	25	46	11,137	12,565	840	184	225	13,814

US	6,010	1,343	542	412	8,307	6,522	1,355	881	778	9,536
RoW	1,622	25	138	524	2,309	2,068	27	239	479	2,813
	56,026	10,478	5,010	15,856	87,370	63,270	10,311	6,663	17,942	98,186

	2010					2009				
	Investment		Development			Investment		Development		
	Core	Non-Core	Core	Non-Core	Total	Core	Non-Core	Core	Non-Core	Total
By geography (1)	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
UK (excluding Northern Ireland)	26,168	14,066	5,997	3,819	50,050	29,195	14,578	7,482	4,548	55,803
Island of Ireland	3,159	3,044	963	8,401	15,567	4,699	1,732	3,702	6,087	16,220
Western Europe	409	10,657	25	46	11,137	905	12,500	215	194	13,814
US	3,375	3,978	733	221	8,307	3,193	4,684	1,289	370	9,536
RoW	244	1,404	488	173	2,309	91	2,004	383	335	2,813
	33,355	33,149	8,206	12,660	87,370	38,083	35,498	13,071	11,534	98,186

Note:
(1) Excludes RRM and contingent obligations.

Key points

- The decrease in exposure occurred primarily in the UK and Europe in the development and investment books. The asset mix remains relatively unchanged.
- Commercial real estate will remain challenging for key markets, such as the UK, Republic of Ireland and US; new business will be accommodated within a reduced limit framework.
- Liquidity in the market remains low with focus on refinancing and support for the existing client base.
- The Ulster Bank Non-Core increase relative to 2009 reflects the swapping of the residual mortgage portfolio for the Commercial real estate portfolio with Ulster Bank Core in the third quarter of 2010.

*unaudited

Risk management: Credit risk continued
Credit risk assets* continued
Key credit portfolios
Commercial real estate continued

By sub-sector (1)	2010 UK (excl NI) £m	Island of Ireland £m	Western Europe £m	US £m	RoW £m	Total £m	2009 UK (excl NI) £m	Island of Ireland £m	Western Europe £m	US £m	RoW £m	Total £m
Residential	15,551	7,726	753	1,755	549	26,334	17,197	7,352	1,065	2,134	505	28,253
Office	8,551	1,402	4,431	1,311	891	16,586	9,381	1,536	5,034	1,614	975	18,540
Retail	4,928	674	711	529	106	6,948	5,760	686	998	492	700	8,636
Industrial	10,413	1,780	3,309	2,193	284	17,979	11,378	2,599	3,592	2,053	402	20,024
Mixed/Other	10,607	3,985	1,933	2,519	479	19,523	12,087	4,047	3,125	3,243	231	22,733
	50,050	15,567	11,137	8,307	2,309	87,370	55,803	16,220	13,814	9,536	2,813	98,186

Maturity profile of portfolio (1)	2010 £m
< 1 year (2)	22,514
1-2 years	18,085
2-3 years	12,848
> 3 years	33,923
	87,370

Notes:
(1) Excludes RRM and contingent obligations.
(2) Includes on demand and past due assets.

Key points
- Of the total portfolio at 31 December 2010, £45.5 billion (2009 - £58.1 billion) is managed normally with annual reviews, £9.2 billion (2009 - £17.9 billion) is receiving heightened credit oversight under the Group watchlist process ("watch") and £32.6 billion (2009 - £22.2 billion) is managed within the GRG.

- As at 31 December 2010, 55% of the Group's credit risk assets rated AQ10 related to the property sector, up from 51% at 31 December 2009. Consistent with the trend seen in the total portfolio, the rate of migration to default slowed during the second half of 2010 in most portfolios. In Non-Core and Ulster Bank property remains the primary driver of growth in the defaulted loan book.

- Short-term lending to property developers without firm long-term financing in place is characterised as speculative. Speculative lending at origination represents less than 2% of the portfolio. The Group's appetite for originating speculative commercial real estate lending is very limited and any such business requires senior management approval. Current market conditions have resulted in some borrowers experiencing difficulty in finalising long-term finance arrangements. These borrowers are managed within the problem debt management process in "watch" or the GRG.

- Tighter risk appetite criteria for new business origination have been implemented during the year but will take time to be reflected in the performance of the portfolio. Whilst there has been some recovery in the value of prime properties in the UK, the Group observes that it has been selective. To date this improvement has not fed through into lower quality properties in the UK and has not been evident in other regions, notably the eurozone, Republic of Ireland and the US.

- The Group may agree maturity extensions, interest roll-ups and other remedial measures, as part of the Group's early problem management framework for customers experiencing temporary financial difficulties. Excluding Ulster Bank Group, customers with loans totalling £0.6 billion (where exposures exceeded £10 million) benefited from such measures during 2010. Within GRG a restructured loan without an impairment provision is returned to the performing book once the revised terms are being met by the customer. During 2010, within GRG (excluding Ulster Bank Group), such activity for counterparties with exposures in excess of £5 million amounted to £0.3 billion. Refer to page 101 for a discussion on Ulster Bank Group.

* unaudited

Risk management: Credit risk continued
Credit risk assets* continued
Key credit portfolios continued

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

Personal credit risk assets (1)	2010 £m	2009 £m	2008 £m
UK Retail			
- mortgages	92,592	85,529	74,528
- cards, loans and overdrafts	18,072	20,316	22,475
Ulster Bank			
- mortgages	21,162	22,304	24,531
- other personal	1,017	1,172	1,350
Citizens			
- mortgages	24,575	26,534	34,394
- auto and cards	6,062	6,917	9,126
- other (2)	3,455	4,205	5,286
Other (3)	18,123	16,827	24,764
	185,058	183,804	196,454

Notes:
(1) Prior years have been revised to reflect improvements in data categorisation.
(2) Mainly student loans and recreational vehicles/marine.
(3) Personal exposures in other divisions.

Refer to the section on Ulster Bank group on page 104 for discussion on Ulster Bank residential mortgages.

Residential mortgages
The table below details the distribution of residential mortgages by indexed LTV.

	UK Retail			Citizens		
Distribution by average LTV (1)	2010 %	2009 %	2008 %	2010 %	2009 (2) %	2008 %
<= 50%	38.5	39.2	46.1	25.8	26.4	29.7
> 50% and <= 70%	23.2	21.0	21.5	17.3	16.6	19.7
> 70% and <= 90%	26.2	24.5	19.7	27.4	26.3	31.8
> 90%	12.1	15.3	12.7	29.5	30.7	18.8
Total portfolio average LTV at 31 December	58.2	59.1	54.5	75.3	74.5	69.1
	64.2	67.2	67.2	64.8	62.6	64.3

Average LTV on new originations during the year

Notes:
(1) LTV averages are calculated by transaction volume.
(2) Revised to reflect updated data and analysis completed after the reporting date.
(3) Analysis covers the main mortgage brands in each of the Group's three consumer markets and covers 96% of total mortgage portfolio.

The table below details residential mortgages which are three months or more in arrears (by volume).

	2010	2009	2008
	%	%	%
UK Retail (1)	1.7	1.6	1.3
Citizens	1.4	1.5	0.9

Note:
(1) Based on the 3+ months arrears rate for RBS and NatWest (81% of standard mortgages as at December 2010) together with the equivalent manually applied collections status flag for RBS/NatWest 'Offset' and other brand mortgages; in total 93% of total mortgage assets. The 'One Account' current account mortgage is excluded (£6.7 billion of assets - 7% of assets) of which 0.8% of accounts were 90 days continually in excess of the limit at 31 December 2010 (2009 - 0.6%). Consistent with the way the Council of Mortgage Lenders publishes member arrears information the 3+ month's arrears rate now excludes accounts in repossession and cases with shortfalls post property sale; 2009 data have been revised accordingly.

*unaudited

Risk management: Credit risk continued
Credit risk assets* continued
Key credit portfolios
Retail credit assets: UK residential mortgages continued

Key points

- The UK mortgage portfolio totalled £92.6 billion at 31 December 2010, an increase of 8% from 31 December 2009, due to continued strong sales growth and lower redemption rates in historical terms. Of the total portfolio, 98% is designated as Core business with the primary brands being the Royal Bank of Scotland, NatWest, the One Account and First Active (Non-Core is made up of Direct Line Mortgages). The assets comprise prime mortgage lending and include 6.8% (£6.2 billion) of exposure to residential buy-to-let at 31 December 2010. There is a small legacy self certification book (0.3% of total assets); which was withdrawn from sale in 2004.

- Gross new mortgage lending in 2010 was strong at £15.9 billion. The average LTV for new business during 2010 was 64.2% compared with 67.2% in 2009. The maximum LTV available to new customers remains at 90%. Based on the Halifax House Price index as at September 2010, the book averaged indexed LTV has reduced to 58.2% at 31 December 2010 from 59.1% at 31 December 2009 influenced by favourable house price movements with the proportion of balances in negative equity at 31 December 2010 standing at 6.9% down from 10.9% at 31 December 2009.

- The arrears rate (more than 3 payments in arrears, excluding repossessions and shortfalls post property sale) increased slightly to 1.7% at 31 December 2010 from 1.6% at 31 December 2009. After a period of deterioration the arrears rate has stabilised and has remained broadly stable since late 2009. The arrears rate on the buy-to-let portfolio was 1.3 % at 31 December 2010 (2009 - 1.4%).

- The mortgage impairment charge was £183 million for the year ended 31 December 2010 compared to £129 million for 2009, with a proportion of the 2010 charge (approximately £70 million) being the result of adjustments reflecting reduced expectations of recovery on prior period defaulted debt and refinement of provision methodology. Underlying default trends improved throughout 2010 when compared with 2009. Provisions as a percentage of loans and receivables have increased to 0.37% at 31 December 2010 compared with 0.25% at 31 December 2009. Default and arrears rates remain sensitive to economic developments and are currently supported by the low interest rate environment and strong book growth with recent business yet to mature.

- A number of initiatives aimed at supporting customers experiencing temporary financial difficulties remain in place. Forbearance activities include offering reduced or deferred payment terms on a temporary basis for a period of up to 12 months during which arrears continue to accrue on the account. Forbearance activities in the performing book amounted to £0.6 billion during 2010. It is Group policy not to initiate repossession proceedings for at least six months after arrears are evident. The number of properties repossessed in 2010 was 1,392 compared to 1,251 in 2009.

Citizens real estate

Key points

- Citizens total residential real estate portfolio totalled $38.2 billion at 31 December 2010 (2009 - $42.5 billion). The real estate portfolio comprises $9.7 billion (Core: $8.6 billion; Non-Core: $1.1 billion) of first lien residential mortgages and $28.5 billion (Core: $23.7 billion; Non-Core: $4.8 billion) of home equity loans and lines (first and second lien). Home Equity Core consists of 46% first lien position while Non-Core consists of 97% second lien position. The Core business comprises 84% of the portfolio and Non-Core comprising 16%, with the serviced by others (SBO) portfolio being the largest component at 75% of the Non-Core portfolio.

- Citizens continue to focus primarily on the ‘footprint states’ of New England, Mid-Atlantic and Mid-West targeting low risk products and maintaining conservative risk policies. Loan acceptance criteria were tightened during 2009 to address deteriorating economic and market conditions. As at 31 December 2010, the portfolio consisted of $31.5 billion (82% of the total portfolio) in these footprint states.

- The SBO portfolio is part of Non-Core and consists of purchased pools of home equity loans and lines (96% second lien) with current LTV (105%) and geographic profiles (73% outside of Citizens footprint) leading to an annualised charge-off rate of 10.6% in 2010. The SBO book has been closed to new purchases since the third quarter of 2007 and is in run-off, with exposure down from $5.5 billion at 31 December 2009 to $4.5 billion at 31 December 2010. The arrears rate of the SBO portfolio decreased from 3.1% at 31 December 2009 to 2.7% at 31 December 2010 due to more effective account servicing and collections, following a service conversion in 2009.

- The current weighted average LTV of the real estate portfolio increased slightly from 74.5% at 31 December 2009 to 75.3% at 31 December 2010, driven by a down turn in home prices. The current weighted average LTV of the real estate portfolio excluding SBO is 70.0%.

- The arrears rate decreased slightly from 1.5% at 31 December 2009 to 1.4% at 31 December 2010. Delinquency rates have stabilised in recent months for both residential mortgages and home equity loans and lines. Citizens’ participates in the US Government Home Affordable Modification Program (HAMP) alongside other bank sponsored initiatives. Under HAMP, any borrower requesting a modification must be first reviewed to see if they meet the criteria of this programme. If the borrower does not qualify for HAMP, then they are reviewed for internal modification programmes. The HAMP programme is available only for first lien loans to owner-occupied. All second lien home equity lines and loans are modified using internal programmes.

- The cumulative effect of these arrangements has helped the Group’s customers. Modified loan balances were $566 million at 31 December 2010 (2009 - $235 million).

* unaudited

Risk management: Credit risk continued
Credit risk assets* continued
Key credit portfolios continued

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

	2010		2009		2008	
	Average loans and receivables	Impairment charge as a % of loans and receivables	Average loans and receivables	Impairment charge as a % of loans and receivables	Average loans and receivables	Impairment charge as a % of loans and receivables
Personal lending	£m	%	£m	%	£m	%
UK Retail cards (1)	6,025	5.0	6,101	8.7	6,617	6.4
UK Retail loans (1)	9,863	4.8	12,062	5.9	13,545	3.3
	$m	%	$m	%	$m	%
Citizens cards (2,3)	1,555	9.9	1,772	9.7	2,275	4.9
Citizens auto loans (2)	8,133	0.6	9,759	1.2	11,386	1.1

Notes:
(1) The ratio for UK Retail assets refers to the impairment charges for the year.
(2) The ratio for Citizens refers to charge-offs in the year, net of recoveries realised in the year.
(3) The 2009 data have been revised to exclude the Kroger Personal Finance portfolio, which was sold in 2010.

Key points
- The UK personal lending portfolio, of which 98% is in Core businesses, comprises credit cards, unsecured loans and overdrafts and totalled £18.1 billion at 31 December 2010 (2009 - £20.3 billion), a decrease of 11% due to continued subdued loan recruitment activity and a continuing general market trend of customers repaying unsecured loan balances with cards and current account balances remaining stable. The Non-Core portfolio consists of the direct finance loan portfolios (Direct Line, Lombard, Mint and Churchill), and totalled £0.45 billion at 31 December 2010 (2009 - £0.7 billion).

- Risk appetite continues to be actively managed across all products. Support continues for customers experiencing financial difficulties through “breathing space initiatives” on all unsecured products, whereby a thirty day period is given to allow customers to establish a debt repayment plan. During this time the Group suspends collection activity. A further extension of thirty days can be granted if progress is made and discussions are continuing. Investment in collection and recovery processes continues, addressing both continued support for the Group’s customers and the management of impairments.

- Benefiting from a combination of risk appetite tightening and a more favourable economic environment, impairment losses on unsecured lending have reduced significantly during 2010 from £1,603 million at 31 December 2009 to £991 million at 31 December 2010 with the downward trajectory moderating significantly in the latter part of the year. Impairments will remain sensitive to the external environment.

- Industry benchmarks for cards arrears remain stable, with the Group continuing to perform favourably.

- Outstanding balances for the Citizens credit card portfolio totalled $1.53 billion at 31 December 2010. This figure excludes the Kroger Personal Finance portfolio, which was sold on 27 May 2010. Core assets comprised 86.3% of the portfolio.

- The Citizens cards business has traditionally adopted conservative risk strategies compared to the US market as a whole. Given the economic climate, Citizens has over the past 24 months introduced tighter lending criteria and lower credit limits. These actions have led to improving new business quality and a business performing on par with industry benchmarks (provided by VISA). The latest available metrics show the rate for 60+ days delinquency as a percentage of total outstanding balances at 3.17% in December 2010 (compared to an industry figure of 3.22%) and net contractual charge-offs as a percentage of total outstanding balances at 4.76% in December 2010 (compared to an industry figure of 5.67%). We expect further improvement based on early delinquency trends.

- Citizens is a leading regional provider of retail auto financing to US consumers through a network of 3,433 auto dealers located in 23 US states. Citizens maintain a conservative, prime indirect auto lending credit programme with loss rates that have historically been below national averages. Current outstanding retail auto loan balances totalled $7.9 billion (includes Core and Non-Core) at 31 December 2010 of which 96% of the portfolio is in the Core business. The $324 million of Non-Core auto assets are anticipated to run-off by 2013. The tightening of credit parameters in 2008-09, along with enhanced collection activities and seasonal factors, has resulted in improved credit performance. The net charge-off rate on the total auto portfolio fell to 0.34% at 31 December 2010, down from 1.3% at 31 December 2009. The 30+ DPD delinquency rate fell from 2.6% as of 31 December 2009 to 1.6% at 31 December 2010 even as balances fell by $917 million. The 1.7% 30+ DPD delinquency rate on the total auto loan portfolio at 30 September 2010 Citizens was favourable to the 2.6% nationwide bank indirect auto delinquency rate as reported by Experian.

*unaudited

Risk management: Credit risk continued

Ulster Bank Group (Core and Non-Core)*

Ulster Bank Group accounts for 8% of the Group's total credit risk assets or 7% of the Group's Core credit risk assets. The Irish economy has experienced severe economic headwinds resulting in a substantial rise in unemployment and a steep property value correction over the last two years. Ulster Bank Group has not been immune to the downturn which has resulted in a significant migration of credit quality to lower grades and a substantial increase in loan impairments. Ulster Bank Group's commercial real estate and mortgage portfolios have been acutely affected and these account for 81% of the 2010 impairment charges (2009 - 75%).

Core

Impairment charges increased by £512 million at 31 December 2009 to £1,161 million at 31 December 2010, reflecting the deteriorating economic environment in Ireland with rising default levels across both personal and corporate portfolios. Lower asset values, particularly property related, together with pressure on borrowers with a dependence on consumer spending have resulted in higher corporate loan losses while higher unemployment, lower incomes and increased taxation have driven mortgage impairment increases. Ulster Bank Group is helping customers in this difficult environment. Forbearance policies which are deployed through the 'Flex' initiative are aimed at assisting customers in financial difficulty. These policies have been reviewed in 2010 given the structural problem that exist in Ireland with the scale and duration of customers in financial difficulty. The industry definition in the Republic of Ireland of an unsustainable mortgage (18 months accumulated interest) has been used to underpin the policy which will improve identification of customers where forbearance may not be appropriate. The forbearance portfolios account for 5.8% (7,383 mortgages) of the Ulster Bank Group mortgage portfolio (by value) at 31 December 2010 with 75% of these customers (by value) in amortising or interest only agreements.

Non-Core

Impairment charges increased from £1,277 million at 31 December 2009 to £2,682 million at 31 December 2010, reflecting the deteriorating economic environment in Ireland with rising default levels across the portfolio. Lower asset values, in property related lending and most specifically in development lending have resulted in higher corporate loan losses.

In the third quarter of 2010, £6.1 billion of residential mortgages and some corporate exposures were transferred from Non-Core to Core; at the same time £5 billion of commercial real estate loans were transferred from Core to Non-Core.

Credit risk assets by industry and geography

Credit risk assets include £51 billion and £3 billion of lending to customers and financial institutions respectively, with the remaining exposure company RRM and contingent obligations.

	Republic of Ireland			UK			Other			Total		
Industry sector (1)	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
2010												
Personal	20,064	120	20,184	2,730	22	2,752	5	—	5	22,799	142	22,941
Banks	107	—	107	3	—	3	14	—	14	124	—	124
Non-banks and	167	88	255	46	24	70	4	—	4	217	112	329

financial institutions												
Sovereign (2)	2,174	—	2,174	672	—	672	—	—	—	2,846	—	2,846
Property	3,609	8,431	12,040	2,704	4,281	6,985	305	770	1,075	6,618	13,482	20,100
Retail and leisure	1,923	608	2,531	795	75	870	108	—	108	2,826	683	3,509
Other Corporate	4,033	338	4,371	1,089	88	1,177	198	—	198	5,320	426	5,746
	32,077	9,585	41,662	8,039	4,490	12,529	634	770	1,404	40,750	14,845	55,595
2009												
Personal	16,008	6,302	22,310	2,782	24	2,806	4	—	4	18,794	6,326	25,120
Banks	99	—	99	4	—	4	28	—	28	131	—	131
Non-banks and financial institutions	190	19	209	170	16	186	3	—	3	363	35	398
Sovereign (2)	1,909	—	1,909	347	—	347	—	—	—	2,256	—	2,256
Property	6,686	5,852	12,538	4,540	2,635	7,175	759	413	1,172	11,985	8,900	20,885
Retail and leisure	2,638	288	2,926	579	22	601	126	—	126	3,343	310	3,653
Other Corporate	4,145	228	4,373	894	72	966	131	—	131	5,170	300	5,470
	31,675	12,689	44,364	9,316	2,769	12,085	1,051	413	1,464	42,042	15,871	57,913

Notes:

(1) In the third quarter of 2010, £6.1 billion of residential mortgages and some corporate exposures were transferred from Non-Core; at the same time £5 billion of commercial real estate loans were transferred from Core to Non-Core.

(2) Includes central bank exposures.

* unaudited

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Risk management: Credit risk continued
Ulster Bank Group (Core and Non-Core)* continued

Risk elements in lending and impairments by sector

2010	Gross loans (1) £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Ulster Bank Group								
Mortgages	21,162	1,566	439	7.4	28.0	2.1	336	7
Personal unsecured	1,282	185	158	14.4	85.4	12.3	48	30
Commercial real estate								
- investment	8,138	2,989	1,332	36.7	44.6	16.4	889	—
- development	9,850	6,406	2,820	65.0	44.0	28.6	1,875	—
Other corporate	11,009	2,515	1,228	22.8	48.8	11.2	695	11
	51,441	13,661	5,977	26.6	43.8	11.6	3,843	48
Core								
Mortgages	21,162	1,566	439	7.4	28.0	2.1	294	7
Personal unsecured	1,282	185	158	14.4	85.4	12.3	48	30
Commercial real estate								
- investment	4,284	598	332	14.0	55.5	7.7	259	—
- development	1,090	65	37	6.0	56.9	3.4	116	—
Other corporate	9,039	1,205	667	13.3	55.4	7.4	444	11
	36,857	3,619	1,633	9.8	45.1	4.4	1,161	48
Non-Core								
Mortgages	—	—	—	—	—	—	42	—
Commercial real estate								
- investment	3,854	2,391	1,000	62.0	41.8	25.9	630	—
- development	8,760	6,341	2,783	72.4	43.9	31.8	1,759	—
Other corporate	1,970	1,310	561	66.5	42.8	28.5	251	—
	14,584	10,042	4,344	68.9	43.3	29.8	2,682	—

Note:
(1) Funded loans.

*unaudited

Risk management: Credit risk continued
Ulster Bank Group (Core and Non-Core)* continued

2009	Gross loans (1) £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Ulster Bank Group								
Mortgages	22,201	882	153	4.0	17.3	0.7	116	3
Personal unsecured	2,433	174	145	7.2	83.3	6.0	66	27
Commercial real estate								
- investment	8,192	1,748	413	21.3	23.6	5.0	370	—
- development	10,109	4,268	1,106	42.2	25.9	10.9	953	4
Other corporate	12,479	1,976	648	15.8	32.8	5.2	421	—
	55,414	9,048	2,465	16.3	27.2	4.4	1,926	34
Core								
Mortgages	16,199	558	102	3.4	18.3	0.6	74	3
Personal unsecured	2,433	174	145	7.2	83.3	6.0	66	27
Commercial real estate								
- investment	6,131	250	105	4.1	42.0	1.7	84	—
- development	3,838	428	284	11.2	66.4	7.4	221	4
Other corporate	11,106	850	326	7.7	38.4	2.9	204	—
	39,707	2,260	962	5.7	42.6	2.4	649	34
Non-Core								
Mortgages	6,002	324	51	5.4	15.7	0.8	42	—
Commercial real estate								
- investment	2,061	1,498	308	72.7	20.6	14.9	286	—
- development	6,271	3,840	822	61.2	21.4	13.1	732	—
Other corporate	1,373	1,126	322	82.0	28.6	23.5	217	—
	15,707	6,788	1,503	43.2	22.1	9.6	1,277	—

Note:
(1) Funded loans.

Key points
- Increases in REIL reflect difficult conditions in both commercial and residential sectors in the Republic of Ireland. Of the REIL at 31 December 2010, 74% was in Non-Core.

- Provisions increased from £2.5 billion to £6.0 billion and the coverage ratio increased to 44% from 27% at 31 December 2009. 69% of the provision at 31 December 2010 related to commercial real estate.

* unaudited

Risk management: Credit risk continued
Ulster Bank Group (Core and Non-Core)* continued

Residential mortgages
The table below shows how the steep value correction has affected the distribution of residential mortgages by loan-to-value (LTV) (indexed). LTV is based upon gross loan amounts and, whilst including defaulted loans, does not account for impairments already taken.

	2010	2009	2008
By average LTV (1)	%	%	%
<= 50%	35.9	40.7	47.1
> 50% and <= 70%	13.5	15.2	17.1
> 70% and <= 90%	13.5	15.5	18.2
> 90%	37.1	28.6	17.6
Total portfolio average LTV at 31 December	71.2	62.5	54.3
Average LTV on new originations during the year	75.9	72.8	71.1

Note:
(1) LTV averages calculated by transaction volume.

Key points
- The residential mortgage portfolio across Ulster Bank Group totalled £21.2 billion at 31 December 2010; with 90% in the Republic of Ireland and 10% in Northern Ireland. The portfolio size has declined by 4% in the Republic of Ireland since 31 December 2009 with Northern Ireland increasing by 12% over the same period. New business originations continue to be very low, especially in the Republic of Ireland. In 2010, 3,557 new mortgages were originated of which, 92% were in Northern Ireland.

- The arrears rate continues to increase due to the continued challenging economic environment. At 31 December 2010, the arrears rate was 6.0%, compared to 3.3% at 31 December 2009. As a result, the impairment charge for 2010 was £336 million compared with £116 million for 2009. Repossessions totalled 76 in 2010, compared with 96 in 2009; 75% of the repossessions were voluntary.

- Ulster Bank Group has a number of initiatives in place aimed at increasing the level of support to customers experiencing temporary financial difficulties. At 31 December 2010, forbearance arrangements had been agreed in respect of 5.8% (£1.2 billion) of Ulster Bank Group's residential mortgage portfolio. The majority (79%) relates to customers in the performing book. Loans in respect of which forbearance arrangements were agreed during 2010 amounted to £1.7 billion in the performing book and £0.5 billion in the impaired book.

*unaudited

Risk management: Credit risk continued
Ulster Bank Group (Core and Non-Core)* continued

Commercial real estate
The Commercial real estate lending portfolio for Ulster Bank Group totalled £18 billion at 31 December 2010 and decreased by 2% during the year. The Non-Core portion of the portfolio totalled £12.6 billion (70% of the portfolio). Of the total Ulster commercial real estate portfolio, 24% is in Northern Ireland, 63% is in the Republic of Ireland and 13% is in the UK.

The definition of commercial real estate was revised during 2010 to include commercial investment properties, residential investment properties, commercial development properties and residential development properties which include house builders.

	Development		Investment		
	Commercial	Residential	Commercial	Residential	Total
Exposure by geography	£m	£m	£m	£m	£m
2010					
Island of Ireland	2,785	6,578	5,072	1,098	15,533
UK (excluding Northern Ireland)	110	359	1,831	115	2,415
Other	—	17	22	1	40
	2,895	6,954	6,925	1,214	17,988
2009					
Island of Ireland	3,404	6,305	5,453	1,047	16,209
UK (excluding Northern Ireland)	240	153	1,586	83	2,062
Other	—	7	1	22	30
	3,644	6,465	7,040	1,152	18,301

Property remains the primary driver of growth in the defaulted loan book for Ulster Bank Group. The outlook remains challenging with limited liquidity in the marketplace to support refinancing. The decrease in asset valuations has placed pressure on the portfolio with more clients seeking renegotiation of terms in the context of granting structural enhancements.

Within its early problem management framework, Ulster Bank Group may agree various remedial measures with customers in the performing book that are experiencing temporary financial difficulties. During 2010, customers with loans amounting to £0.4 billion (exposures greater than £5 million) benefited from such measures. During 2010, impaired loans amounting to £2.1 billion (exposures greater than £5 million) were restructured and remain in the non-performing book.

* unaudited

Risk management: Credit risk continued
Balance sheet analysis
All the disclosures in this section (pages 106 to 120) are audited unless otherwise indicated by an asterisk (*).

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

Industry and geographical analysis
The tables below and on pages 107 to 113 analyse total financial assets gross of provisions by industry sector (for Group before RFS MI) and geography (for Group before RFS MI and RFS MI).

Industry analysis
The table below analyses total financial assets by industry.

	Loans and advances							Netting and
	Core	Non-Core	Total	Securities	Derivatives	Other (1)	Total	offset (2)
2010	£m	£m	£m	£m	£m	£m	£m	£m
Total								
Central and local government	7,426	1,671	9,097	130,890	7,560	291	147,838	3,916
Finance - banks	99,583	1,024	100,607	—	—	—	100,607	—
- other (3)	97,967	7,891	105,858	95,954	399,318	12,185	613,315	403,387
Residential mortgages	140,359	6,142	146,501	808	6	—	147,315	14
Personal lending	33,581	3,891	37,472	63	15	48	37,598	11
Property	42,455	47,651	90,106	2,937	3,830	28	96,901	1,041
Construction	8,680	3,352	12,032	87	780	—	12,899	1,392
Manufacturing	26,186	6,520	32,706	897	3,229	—	36,832	2,156
Service industries and business activities	95,252	22,384	117,636	8,077	12,285	388	138,386	6,400
Agriculture, forestry and fishing	3,758	135	3,893	29	40	—	3,962	94
Finance lease and instalment credit	8,320	8,530	16,850	15	14	—	16,879	134
Interest accruals	921	279	1,200	1,398	—	—	2,598	—
Total gross of provisions	564,488	109,470	673,958	241,155	427,077	12,940	1,355,130	418,545
Provisions			(18,182)	(1,477)	—	(29)	(19,688)	n/a
Group before RFS MI			655,776	239,678	427,077	12,911	1,335,442	418,545
RFS MI gross of provisions			2	—	—	—	2	—
Group			655,778	239,678	427,077	12,911	1,335,444	418,545

Comprising:

Repurchase agreements	10,712

Derivative balances	361,493
Derivative collateral	31,015
Other	15,325
	418,545

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

2009	Loans and advances Core £m	Loans and advances Non-Core £m	Loans and advances Total £m	Securities £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
Total								
Central and local government	6,388	1,532	7,920	142,812	6,998	205	157,935	1,725
Finance - banks	81,695	1,937	83,632	—	—	—	83,632	—
- other (3)	88,617	11,957	100,574	99,284	409,452	12,110	621,420	372,343
Residential mortgages	127,975	12,932	140,907	717	11	—	141,635	7
Personal lending	35,313	6,358	41,671	1	38	40	41,750	21
Property	49,054	50,372	99,426	4,497	4,184	108	108,215	1,114
Construction	9,502	5,258	14,760	615	923	63	16,361	1,450
Manufacturing	30,454	14,402	44,856	1,954	5,353	116	52,279	3,184
Service industries and business activities	100,729	33,662	134,391	14,519	11,180	794	160,884	5,811
Agriculture, forestry and fishing	3,726	553	4,279	254	44	9	4,586	76
Finance lease and instalment credit	8,147	11,956	20,103	306	16	—	20,425	39
Interest accruals	1,667	555	2,222	1,571	—	—	3,793	—
Total gross of provisions	543,267	151,474	694,741	266,530	438,199	13,445	1,412,915	385,770
Provisions			(15,173)	(1,475)	—	—	(16,648)	n/a
Group before RFS MI			679,568	265,055	438,199	13,445	1,396,267	385,770
RFS MI gross of provisions			142,688	21,730	3,255	9	167,682	55
RFS MI provision			(2,110)	(3)	—	—	(2,113)	n/a
Group			820,146	286,782	441,454	13,454	1,561,836	385,825

2008	Loans and advances £m	Securities £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
Total						
Central and local government	15,497	100,099	6,382	197	122,175	1,987
Finance - banks	127,287	—	—	—	127,287	—
- other (3)	139,083	146,869	938,819	16,026	1,240,797	836,404
Residential mortgages	139,391	29	18	—	139,438	52
Personal lending	51,070	278	60	25	51,433	34
Property	103,276	2,494	5,586	71	111,427	1,067
Construction	20,250	213	984	32	21,479	1,488
Manufacturing	71,165	1,413	14,159	308	87,045	6,498
Service industries and business activities	169,844	22,764	25,417	2,463	220,488	10,918
Agriculture, forestry and fishing	4,628	144	45	16	4,833	87

Finance lease and instalment credit	22,355	23	25	—	22,403	119
Interest accruals	6,369	1,241	—	—	7,610	—
Total gross of provisions	870,215	275,567	991,495	19,138	2,156,415	858,654
Provisions	(9,451)	(210)	—	—	(9,661)	n/a
Group before RFS MI	860,764	275,357	991,495	19,138	2,146,754	858,654
RFS MI gross of provisions	153,720	18,522	1,064	20	173,326	14
RFS MI provision	(1,565)	—	—	—	(1,565)	n/a
Group	1,012,919	293,879	992,559	19,158	2,318,515	858,668

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

Loans and advances to banks and customers by geography
The table below analyses loans and advances gross of provisions by geography (location of office).

	2010 £m	2009 £m	2008 £m
Loans and advances to banks (1)			
- UK	70,400	59,348	106,913
- US	9,810	8,537	5,830
- Europe	10,655	5,535	7,670
- RoW	9,778	10,611	9,213
Group before RFS MI	100,643	84,031	129,626
RFS MI	2	7,879	8,698
	100,645	91,910	138,324
Loans and advances to customers			
- UK	374,822	386,798	431,302
- US	90,752	93,209	125,786
- Europe	83,586	102,571	135,524
- RoW	24,155	28,132	47,977
Group before RFS MI	573,315	610,710	740,589
RFS MI	—	134,809	145,022
	573,315	745,519	885,611
Group before RFS MI	673,958	694,741	870,215
RFS MI	2	142,688	153,720
Group	673,960	837,429	1,023,935

Note:
(1) Loans and advances to banks includes £36 million of accrued interest (2009 - £399 million; 2008 - £2,339 million).

Key points

- Residential mortgages increased by £6 billion during 2010 with increases in UK Retail, reflecting continued strong sales growth and lower redemption rates, partially offset by reduced lending in both Ulster Bank and US Retail & Commercial (US R&C) reflecting low new business originations and tightened loan acceptance criteria respectively.

- Reduction in unsecured lending reflects subdued recruitment activity and the continuing market trend of repaying unsecured loans in UK Retail and lower personal auto loans in US R&C.

- The Group’s loans and advances to property and construction sectors reduced by £12 billion, primarily in the UK and Europe in both development and investment portfolios. Underlying Non-Core property loans declined by £7.7 billion during the year. This was partly offset by a transfer of £5.0 billion in development property loans as part of Ulster Banks strategic decision to cease early stage development property lending.

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Exposure to the manufacturing sector is concentrated in industrial agriculture and food & consumer subsectors. The overall reduction in exposure in the year was partly due to the run off and restructuring of assets in Europe and in the Non Core portfolio.

- Service industries and business activities comprise transport, retail & leisure, telecommunications, media and technology and business services. Transport primarily comprises loans to borrowers in the shipping, automotive and aviation segments. Aviation capital and a portfolio of shipping loans are held within Non-Core. Core portfolios in UK Corporate and GBM are well diversified geographically. Global economic conditions and related trends in trade flows and discretionary consumer spending continue to inform the Group's cautious stance.*

- Shipping continued to experience difficult market conditions in 2010. Whilst there have been no material shipping impairments to date, the exposures subject to a heightened level of monitoring currently stand at £2.8 billion (out of a total portfolio of £13 billion). Recent quarterly vessel valuations undertaken by external shipbrokers show that the majority of the Group's exposures remain fully secured. Conditions are expected to remain challenging for the foreseeable future.*

*unaudited

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

The tables below and on pages 109 to 113 analyse financial assets by geography (location of office) and industry.

	Loans and advances							Netting
						Other		and
	Core	Non-Core	Total	Securities	Derivatives	(1)	Total	offset (2)
2010	£m	£m	£m	£m	£m	£m	£m	£m
UK								
Central and local government	6,339	173	6,512	72,428	7,300	173	86,413	3,916
Finance - banks	69,911	481	70,392	—	—	—	70,392	—
- other (3)	61,180	6,024	67,204	51,015	249,324	5,390	372,933	256,949
Residential mortgages	99,928	1,665	101,593	748	6	—	102,347	14
Personal lending	23,035	585	23,620	1	9	23	23,653	11
Property	34,970	30,492	65,462	2,477	3,739	28	71,706	1,041
Construction	7,041	2,310	9,351	39	741	—	10,131	1,392
Manufacturing	12,689	1,510	14,199	354	2,159	—	16,712	2,150
Service industries and business activities	58,265	11,742	70,007	2,993	7,940	337	81,277	6,306
Agriculture, forestry and fishing	2,872	67	2,939	—	35	—	2,974	94
Finance lease and instalment credit	5,589	7,785	13,374	15	14	—	13,403	134
Interest accruals	471	98	569	501	—	—	1,070	—
Group	382,290	62,932	445,222	130,571	271,267	5,951	853,011	272,007
US								
Central and local government	263	53	316	25,741	5	112	26,174	—
Finance - banks	9,798	12	9,810	—	—	—	9,810	—
- other (3)	25,306	826	26,132	23,975	121,717	4,950	176,774	123,862
Residential mortgages	20,548	3,653	24,201	60	—	—	24,261	—
Personal lending	6,816	2,704	9,520	—	—	—	9,520	—
Property	1,611	3,318	4,929	99	23	—	5,051	—
Construction	442	78	520	5	16	—	541	—
Manufacturing	5,459	143	5,602	434	583	—	6,619	—
Service industries and business activities	14,198	2,725	16,923	3,285	2,764	42	23,014	—
Agriculture, forestry and fishing	31	—	31	28	3	—	62	—
Finance lease and instalment credit	2,315	—	2,315	—	—	—	2,315	—
Interest accruals	190	73	263	240	—	—	503	—
Group	86,977	13,585	100,562	53,867	125,111	5,104	284,644	123,862
Europe								
Central and local government	365	1,017	1,382	18,648	66	—	20,096	—
Finance - banks	10,315	312	10,627	—	—	—	10,627	—
- other (3)	2,641	1,019	3,660	17,076	746	53	21,535	1
Residential mortgages	19,473	621	20,094	—	—	—	20,094	—

Personal lending	2,270	600	2,870	62	—	25	2,957	—
Property	5,139	12,636	17,775	43	—	—	17,818	—
Construction	1,014	873	1,887	27	1	—	1,915	—
Manufacturing	5,853	4,181	10,034	105	39	—	10,178	6
Service industries and business activities	17,538	6,071	23,609	900	99	1	24,609	92
Agriculture, forestry and fishing	849	68	917	1	—	—	918	—
Finance lease and instalment credit	369	745	1,114	—	—	—	1,114	—
Interest accruals	170	102	272	575	—	—	847	—
Group before RFS MI	65,996	28,245	94,241	37,437	951	79	132,708	99
RFS MI			2	—	—	—	2	—
Group			94,243	37,437	951	79	132,710	99

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

	Loans and advances							Netting
						Other		and
	Core	Non-Core	Total	Securities	Derivatives	(1)	Total	offset (2)
2010	£m	£m	£m	£m	£m	£m	£m	£m
RoW								
Central and local government	459	428	887	14,073	189	6	15,155	—
Finance - banks	9,559	219	9,778	—	—	—	9,778	—
- other (3)	8,840	22	8,862	3,888	27,531	1,792	42,073	22,575
Residential mortgages	410	203	613	—	—	—	613	—
Personal lending	1,460	2	1,462	—	6	—	1,468	—
Property	735	1,205	1,940	318	68	—	2,326	—
Construction	183	91	274	16	22	—	312	—
Manufacturing	2,185	686	2,871	4	448	—	3,323	—
Service industries and business activities	5,251	1,846	7,097	899	1,482	8	9,486	2
Agriculture, forestry and fishing	6	—	6	—	2	—	8	—
Finance lease and instalment credit	47	—	47	—	—	—	47	—
Interest accruals	90	6	96	82	—	—	178	—
Group	29,225	4,708	33,933	19,280	29,748	1,806	84,767	22,577
2009								
UK								
Central and local government	4,482	276	4,758	79,663	6,752	4	91,177	1,725
Finance - banks	58,141	979	59,120	—	—	—	59,120	—
- other (3)	56,429	8,093	64,522	45,513	257,109	5,492	372,636	238,926
Residential mortgages	90,688	1,896	92,584	653	11	—	93,248	7
Personal lending	24,613	1,137	25,750	1	9	22	25,782	21
Property	36,407	35,387	71,794	3,761	4,086	104	79,745	1,114
Construction	6,964	3,640	10,604	354	849	62	11,869	1,450
Manufacturing	14,644	3,255	17,899	1,643	4,222	102	23,866	3,184
Service industries and business activities	62,756	15,877	78,633	10,279	7,849	742	97,503	5,810
Agriculture, forestry and fishing	2,946	138	3,084	252	39	9	3,384	76
Finance lease and instalment credit	5,343	10,843	16,186	294	16	—	16,496	39
Interest accruals	1,032	180	1,212	457	—	—	1,669	—
Group before RFS MI	364,445	81,701	446,146	142,870	280,942	6,537	876,495	252,352
RFS MI			444	49	1	—	494	—
Group			446,590	142,919	280,943	6,537	876,989	252,352
US								
Central and local government	196	64	260	24,620	9	141	25,030	—
Finance - banks	8,448	76	8,524	—	—	—	8,524	—
- other (3)	19,404	1,803	21,207	27,086	125,599	5,779	179,671	113,670

Residential mortgages	21,842	4,317	26,159	64	—	—	26,223	—
Personal lending	7,373	3,599	10,972	—	—	—	10,972	—
Property	1,498	3,788	5,286	56	30	—	5,372	—
Construction	490	132	622	72	50	—	744	—
Manufacturing	5,895	1,200	7,095	243	580	—	7,918	—
Service industries and business activities	14,358	4,505	18,863	3,320	2,486	—	24,669	—
Agriculture, forestry and fishing	27	—	27	1	2	—	30	—
Finance lease and instalment credit	2,417	—	2,417	—	—	—	2,417	—
Interest accruals	220	94	314	334	—	—	648	—
Group before RFS MI	82,168	19,578	101,746	55,796	128,756	5,920	292,218	113,670
RFS MI			360	—	—	—	360	—
Group			102,106	55,796	128,756	5,920	292,578	113,670

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

	Loans and advances							Netting
						Other		and
	Core	Non-Core	Total	Securities	Derivatives	(1)	Total	offset (2)
2009	£m	£m	£m	£m	£m	£m	£m	£m
Europe								
Central and local government	334	1,164	1,498	25,328	68	24	26,918	—
Finance - banks	4,906	528	5,434	—	—	—	5,434	—
- other (3)	4,161	1,028	5,189	22,913	1,699	43	29,844	—
Residential mortgages	15,055	6,718	21,773	—	—	—	21,773	—
Personal lending	1,877	1,009	2,886	—	—	17	2,903	—
Property	10,812	9,417	20,229	1	17	4	20,251	—
Construction	1,946	1,167	3,113	1	1	1	3,116	—
Manufacturing	7,311	8,609	15,920	42	123	—	16,085	—
Service industries and business activities	19,088	9,895	28,983	331	88	51	29,453	—
Agriculture, forestry and fishing	737	356	1,093	1	—	—	1,094	—
Finance lease and instalment credit	379	1,094	1,473	12	—	—	1,485	—
Interest accruals	266	249	515	706	—	—	1,221	—
Group before RFS MI	66,872	41,234	108,106	49,335	1,996	140	159,577	—
RFS MI			140,098	21,681	3,232	9	165,020	—
Group			248,204	71,016	5,228	149	324,597	—
RoW								
Central and local government	1,376	28	1,404	13,201	169	36	14,810	—
Finance - banks	10,200	354	10,554	—	—	—	10,554	—
- other (3)	8,623	1,033	9,656	3,772	25,045	796	39,269	19,747
Residential mortgages	390	1	391	—	—	—	391	—
Personal lending	1,450	613	2,063	—	29	1	2,093	—
Property	337	1,780	2,117	679	51	—	2,847	—
Construction	102	319	421	188	23	—	632	—
Manufacturing	2,604	1,338	3,942	26	428	14	4,410	—
Service industries and business activities	4,527	3,385	7,912	589	757	1	9,259	1
Agriculture, forestry and fishing	16	59	75	—	3	—	78	—
Finance lease and instalment credit	8	19	27	—	—	—	27	—
Interest accruals	149	32	181	74	—	—	255	—
Group before RFS MI	29,782	8,961	38,743	18,529	26,505	848	84,625	19,748
RFS MI			1,786	—	22	—	1,808	55
Group			40,529	18,529	26,527	848	86,433	19,803

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

2008	Loans and advances £m	Securities £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
UK						
Central and local government	6,106	36,466	5,798	14	48,384	1,987
Finance - banks	105,100	—	—	—	105,100	—
- other (3)	92,030	84,601	532,857	6,257	715,745	480,762
Residential mortgages	80,967	—	14	—	80,981	52
Personal lending	27,469	250	36	25	27,780	5
Property	74,010	2,008	5,094	71	81,183	1,026
Construction	13,426	144	754	26	14,350	1,485
Manufacturing	25,999	1,080	11,208	180	38,467	6,279
Service industries and business activities	88,334	10,154	13,278	1,471	113,237	7,624
Agriculture, forestry and fishing	3,118	93	34	15	3,260	87
Finance lease and instalment credit	17,363	3	25	—	17,391	119
Interest accruals	4,293	774	—	—	5,067	—
Group before RFS MI	538,215	135,573	569,098	8,059	1,250,945	499,426
RFS MI	702	95	—	—	797	—
Group	538,917	135,668	569,098	8,059	1,251,742	499,426
US						
Central and local government	482	24,996	45	33	25,556	—
Finance - banks	5,814	—	—	—	5,814	—
- other (3)	24,618	37,344	355,502	5,754	423,218	323,910
Residential mortgages	34,235	—	—	—	34,235	—
Personal lending	14,368	—	—	—	14,368	—
Property	6,579	5	97	—	6,681	—
Construction	885	63	122	6	1,076	—
Manufacturing	13,127	102	1,809	128	15,166	217
Service industries and business activities	27,914	1,498	8,535	907	38,854	2,346
Agriculture, forestry and fishing	30	—	3	1	34	—
Finance lease and instalment credit	3,066	—	—	—	3,066	—
Interest accruals	498	466	—	—	964	—
Group before RFS MI	131,616	64,474	366,113	6,829	569,032	326,473
RFS MI	491	2	—	—	493	—
Group	132,107	64,476	366,113	6,829	569,525	326,473

For notes to this table refer to page 113.

Risk management: Credit risk continued
Balance sheet analysis: Industry and geography analysis continued

2008	Loans and advances £m	Securities £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
Europe						
Central and local government	1,830	21,929	228	5	23,992	—
Finance - banks	7,274	—	—	—	7,274	—
- other (3)	10,480	20,657	7,840	3,608	42,585	—
Residential mortgages	23,394	29	4	—	23,427	—
Personal lending	4,641	28	19	—	4,688	—
Property	19,769	1	299	—	20,069	—
Construction	5,183	—	91	—	5,274	—
Manufacturing	25,843	53	371	—	26,267	2
Service industries and business activities	40,444	10,163	2,347	85	53,039	840
Agriculture, forestry and fishing	1,327	50	1	—	1,378	—
Finance lease and instalment credit	1,815	15	—	—	1,830	—
Interest accruals	1,194	1	—	—	1,195	—
Group before RFS MI	143,194	52,926	11,200	3,698	211,018	842
RFS MI	150,304	18,367	1,009	20	169,700	1
Group	293,498	71,293	12,209	3,718	380,718	843
RoW						
Central and local government	7,079	16,708	311	145	24,243	—
Finance - banks	9,099	—	—	—	9,099	—
- other (3)	11,955	4,267	42,620	407	59,249	31,732
Residential mortgages	795	—	—	—	795	—
Personal lending	4,592	—	5	—	4,597	29
Property	2,918	480	96	—	3,494	41
Construction	756	6	17	—	779	3
Manufacturing	6,196	178	771	—	7,145	—
Service industries and business activities	13,152	949	1,257	—	15,358	108
Agriculture, forestry and fishing	153	1	7	—	161	—
Finance lease and instalment credit	111	5	—	—	116	—
Interest accruals	384	—	—	—	384	—
Group before RFS MI	57,190	22,594	45,084	552	125,420	31,913
RFS MI	2,223	58	55	—	2,336	13
Group	59,413	22,652	45,139	552	127,756	31,926

Notes:
(1) Includes settlement balances of £11,605 million at 31 December 2010 (2009 - £12,033 million; 2008 - £17,832 million).
(2)

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

(3) Loans made by the Group's consolidated conduits to asset owning companies are included within Finance.

Risk management: Credit risk continued
Balance sheet analysis continued

Asset quality

The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings agencies and are therefore excluded from the table below and are set out on pages 116 and 117.

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

2010	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Total									
AQ1	56,655	91,952	126,444	6,815	408,489	658	78,728	9,745	779,486
AQ2	14	598	13,282	1,271	2,659	3	26,128	1,980	45,935
AQ3	48	2,197	25,981	156	3,317	—	25,731	4,337	61,767
AQ4	188	639	95,777	571	3,391	6	41,027	6,522	148,121
AQ5	99	2,322	114,796	64	4,860	144	38,612	5,169	166,066
AQ6	3	159	65,497	34	1,070	—	25,991	2,230	94,984
AQ7	2	178	46,072	1	857	69	18,752	2,456	68,387
AQ8	—	15	16,573	14	403	—	9,289	9,545	35,839
AQ9	—	115	14,263	2	450	80	3,889	932	19,731
AQ10	5	355	5,644	2	1,581	—	2,829	407	10,823
Past due	—	10	13,430	2,675	—	—	—	—	16,115
Impaired	—	145	35,556	—	—	375	—	—	36,076
Impairment provision	—	(127)	(18,055)	—	—	(29)	—	—	(18,211)

Group before RFS MI	57,014	98,558	555,260	11,605	427,077	1,306	270,976	43,323	1,465,119
RFS MI	—	2	—	—	—	—	—	32	34
Group	57,014	98,560	555,260	11,605	427,077	1,306	270,976	43,355	1,465,153
Core									
AQ1	56,637	91,298	103,645	6,814	396,419	366	71,091	9,651	735,921
AQ2	14	550	10,534	1,271	2,243	3	24,923	1,728	41,266
AQ3	48	2,165	22,851	155	3,132	—	23,546	4,268	56,165
AQ4	10	539	85,779	571	3,017	6	36,909	5,070	131,901
AQ5	99	2,247	100,051	64	3,988	15	35,302	4,924	146,690
AQ6	3	138	53,498	34	805	—	24,050	2,140	80,668
AQ7	2	154	38,438	1	595	69	17,605	2,309	59,173
AQ8	—	15	13,290	14	257	—	8,617	9,434	31,627
AQ9	—	107	9,898	2	237	50	3,442	886	14,622
AQ10	5	300	2,777	2	368	—	1,500	250	5,202
Past due	—	3	10,744	2,629	—	—	—	—	13,376
Impaired	—	144	13,367	—	—	375	—	—	13,886
Impairment provision	—	(126)	(7,740)	—	—	(29)	—	—	(7,895)
Group before RFS MI	56,818	97,534	457,132	11,557	411,061	855	246,985	40,660	1,322,602

For the note to this table refer to page 116.

Risk management: Credit risk continued
Balance sheet analysis: Asset quality continued

2010	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Non-Core									
AQ1	18	654	22,799	1	12,070	292	7,637	94	43,565
AQ2	—	48	2,748	—	416	—	1,205	252	4,669
AQ3	—	32	3,130	1	185	—	2,185	69	5,602
AQ4	178	100	9,998	—	374	—	4,118	1,452	16,220
AQ5	—	75	14,745	—	872	129	3,310	245	19,376
AQ6	—	21	11,999	—	265	—	1,941	90	14,316
AQ7	—	24	7,634	—	262	—	1,147	147	9,214
AQ8	—	—	3,283	—	146	—	672	111	4,212
AQ9	—	8	4,365	—	213	30	447	46	5,109
AQ10	—	55	2,867	—	1,213	—	1,329	157	5,621
Accruing past due	—	7	2,686	46	—	—	—	—	2,739
Impaired	—	1	22,189	—	—	—	—	—	22,190
Impairment provision	—	(1)	(10,315)	—	—	—	—	—	(10,316)
Group before RFS MI	196	1,024	98,128	48	16,016	451	23,991	2,663	142,517
2009									
AQ1	51,521	72,384	106,062	6,582	389,019	754	62,085	9,446	697,853
AQ2	—	1,725	10,780	306	11,550	9	27,598	4,526	56,494
AQ3	1	2,175	29,958	199	10,791	—	28,364	6,088	77,576
AQ4	23	1,357	102,922	605	8,296	—	52,496	14,948	180,647
AQ5	2	2,497	124,724	149	8,270	37	43,239	7,387	186,305
AQ6	1	424	94,513	40	2,548	—	30,847	2,448	130,821
AQ7	—	110	46,928	33	2,181	98	26,724	2,352	78,426
AQ8	—	137	23,593	—	1,448	—	12,507	1,008	38,693
AQ9	—	184	16,025	—	2,030	—	5,141	1,279	24,659
AQ10	—	277	9,142	3	2,026	—	3,618	507	15,573
Accruing past due	—	36	14,475	3,910	40	—	—	—	18,461
Impaired	—	206	31,588	197	—	—	—	—	31,991
Impairment provision	—	(157)	(15,016)	—	—	—	—	—	(15,173)
Group before RFS MI	51,548	81,355	595,694	12,024	438,199	898	292,619	49,989	1,522,326
RFS MI	713	7,865	132,699	9	3,255	—	5,022	4,031	153,594
Group	52,261	89,220	728,393	12,033	441,454	898	297,641	54,020	1,675,920

For the note to this table refer to page 116.

Risk management: Credit risk continued
Balance sheet analysis: Asset quality continued

2008	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
AQ1	9,314	93,845	141,636	8,468	837,899	475	122,075	10,268	1,223,980
AQ2	506	6,380	18,440	1,229	27,207	31	23,113	2,129	79,035
AQ3	1,005	12,556	62,235	1,938	35,719	62	26,267	2,843	142,625
AQ4	1,005	11,041	129,292	1,422	46,057	62	63,966	13,196	266,041
AQ5	—	1,048	160,605	252	26,799	—	63,599	17,738	270,041
AQ6	—	673	99,765	217	6,581	222	17,771	11,254	136,483
AQ7	—	201	56,762	248	4,452	—	17,740	7,602	87,005
AQ8	—	292	23,449	—	1,362	—	14,120	1,170	40,393
AQ9	—	343	12,265	9	2,022	—	5,814	1,061	21,514
AQ10	—	274	5,844	—	3,386	—	1,827	435	11,766
Accruing past due	—	—	13,262	4,029	11	—	—	—	17,302
Impaired	—	129	17,034	—	—	—	—	—	17,163
Impairment provision	—	(127)	(9,324)	—	—	—	—	—	(9,451)
Group before RFS MI	11,830	126,655	731,265	17,812	991,495	852	356,292	67,696	2,303,897
RFS MI	570	8,676	143,457	20	1,064	—	5,432	3,841	163,060
Group	12,400	135,331	874,722	17,832	992,559	852	361,724	71,537	2,466,957

Note:
(1) Excluding items in the course of collection from other banks of £1,958 million (2009 - £2,533 million; 2008 - £2,888 million).

Debt securities
The table below analyses debt securities by issuer and external ratings.

	Central and local government			Banks and building societies	ABS (1)	Corporate	Other	Total	% of total
2010	UK £m	US £m	Other £m	£m	£m	£m	£m	£m	
Total									
AAA	13,486	33,846	44,784	2,374	51,235	846	17	146,588	67
AA to AA+	—	—	18,025	3,036	6,335	779	—	28,175	13

A to AA-	—	—	9,138	4,185	3,244	1,303	5	17,875	8
BBB- to A-	—	—	2,843	1,323	3,385	2,029	6	9,586	5
Non-investment grade	—	—	1,766	1,766	4,923	2,786	4	11,245	5
Unrated	—	—	52	310	1,703	1,722	224	4,011	2
	13,486	33,846	76,608	12,994	70,825	9,465	256	217,480	100
Core									
AAA	13,110	33,535	44,761	2,205	47,441	807	16	141,875	70
AA to AA+	—	—	18,025	2,908	3,656	775	—	25,364	13
A to AA-	—	—	9,138	4,007	1,879	1,223	5	16,252	8
BBB- to A-	—	—	2,843	1,297	1,108	1,956	6	7,210	4
Non-investment grade	—	—	1,460	1,638	3,052	2,428	2	8,580	4
Unrated	—	—	52	297	978	1,077	212	2,616	1
	13,110	33,535	76,279	12,352	58,114	8,266	241	201,897	100
Non-Core									
AAA	376	311	23	169	3,794	39	1	4,713	30
AA to AA+	—	—	—	128	2,679	4	—	2,811	18
A to AA-	—	—	—	178	1,365	80	—	1,623	11
BBB- to A-	—	—	—	26	2,277	73	—	2,376	15
Non-investment grade	—	—	306	128	1,871	358	2	2,665	17
Unrated	—	—	—	13	725	645	12	1,395	9
	376	311	329	642	12,711	1,199	15	15,583	100

For the note to this table refer to page 117.

Risk management: Credit risk continued
Balance sheet analysis: Debt securities continued

	Central and local government			Banks and building societies	ABS (1)	Corporate	Other	Total	% of total
	UK	US	Other						
2009	£m	£m	£m	£m	£m	£m	£m	£m	(2)
AAA	26,601	23,219	44,396	4,012	65,067	2,263	—	165,558	66
AA to AA+	—	—	22,003	4,930	8,942	1,429	—	37,304	15
A to AA-	—	—	13,159	3,770	3,886	1,860	—	22,675	9
BBB- to A-	—	—	3,847	823	4,243	2,187	—	11,100	5
Non-investment grade	—	—	353	169	3,515	2,042	—	6,079	2
Unrated	—	—	504	289	1,949	2,601	1,036	6,379	3
Group before RFS MI	26,601	23,219	84,262	13,993	87,602	12,382	1,036	249,095	100
RFS MI	721	183	11,871	3,803	580	906	95	18,159	
Group	27,322	23,402	96,133	17,796	88,182	13,288	1,131	267,254	
2008									
AAA	18,787	16,514	43,197	8,126	93,853	3,953	—	184,430	73
BBB- to AA+	—	—	15,862	13,013	11,437	10,172	—	50,484	20
Non-investment grade	—	—	242	127	3,678	2,259	—	6,306	2
Unrated	—	—	409	1,445	2,175	4,517	3,393	11,939	5
Group before RFS MI	18,787	16,514	59,710	22,711	111,143	20,901	3,393	253,159	100
RFS MI	—	7	10,761	1,652	—	885	1,085	14,390	
Group	18,787	16,521	70,471	24,363	111,143	21,786	4,478	267,549	

Notes:
(1) Asset-backed securities.
(2) Percentage calculated on Group before RFS MI.

Key points
- The proportion of AAA rated securities was broadly unchanged during the year whilst the proportion of non-investment grade and unrated securities increased from 5% to 7%.
- Holdings of debt securities issued by non-investment grade governments comprised: Greece £1.0 billion; Romania £0.3 billion; Turkey £0.2 billion; and Indonesia £0.2 billion.
- Increase in non-investment grade securities reflects purchases by GBM's mortgage trading business. Non-investment grade securities also increased as a result of credit downgrades and rating withdrawals of certain ABS structures in Non-Core during the year.

Risk management: Credit risk continued

Balance sheet analysis: Debt securities continued

The table below analyses debt securities by issuer and measurement classification. Net numbers below are illustrative only and do not reflect net presentation under IFRS.

	Central and local government			Banks and building societies	ABS	Corporate	Other	Total
	UK	US	Other					
2010	£m	£m	£m	£m	£m	£m	£m	£m
Held-for-trading (HFT)	5,097	15,956	43,224	5,778	21,988	6,590	236	98,869
Designated as at fair value through profit or loss	1	—	262	3	119	16	1	402
Available-for-sale	8,377	17,890	33,122	7,198	42,515	2,011	17	111,130
Loans and receivables	11	—	—	15	6,203	848	2	7,079
Total	13,486	33,846	76,608	12,994	70,825	9,465	256	217,480
Short positions (HFT)	(4,200)	(11,398)	(18,909)	(1,853)	(1,335)	(3,288)	(34)	(41,017)
Net	9,286	22,448	57,699	11,141	69,490	6,177	222	176,463
2009								
Held-for-trading	8,128	10,427	50,150	6,103	28,820	6,892	893	111,413
Designated as at fair value through profit or loss	122	3	385	418	394	1,087	20	2,429
Available-for-sale	18,350	12,789	33,727	7,472	50,464	2,550	30	125,382
Loans and receivables	1	—	—	—	7,924	1,853	93	9,871
Group before RFS MI	26,601	23,219	84,262	13,993	87,602	12,382	1,036	249,095
RFS MI	721	183	11,871	3,803	580	906	95	18,159
Short positions (HFT)	(5,805)	(8,957)	(14,491)	(1,951)	(3,616)	(2,199)	(512)	(37,531)
Net	21,517	14,445	81,642	15,845	84,566	11,089	619	229,723
2008								
Held-for-trading	5,372	9,859	37,518	10,947	39,879	11,013	1,571	116,159
Designated as at fair value through profit or loss	2,085	510	456	—	236	1,551	456	5,294
Available-for-sale	11,330	6,145	21,735	11,650	62,067	4,588	1,207	118,722
Loans and receivables	—	—	—	114	8,961	3,749	160	12,984
Group before RFS MI	18,787	16,514	59,709	22,711	111,143	20,901	3,394	253,159
RFS MI	—	7	10,762	1,652	—	885	1,084	14,390
Group	18,787	16,521	70,471	24,363	111,143	21,786	4,478	267,549

Key point

- Debt securities continued to decline during 2010, primarily in GBM's European sovereign exposures as well as in ABS. Reduction in ABS in US Retail & Commercial and Non-Core reflects balance sheet reduction strategies whereas GBM's sell down followed increased liquidity in US RMBS market, primarily in the first half of the year.

Risk management: Credit risk continued
Balance sheet analysis continued

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

	2010						
	0-3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m	2009 Total £m
AQ1	30,840	10,755	17,554	135,311	214,029	408,489	389,019
AQ2	319	105	212	1,561	462	2,659	11,550
AQ3	1,284	391	626	610	406	3,317	10,791
AQ4	989	155	240	1,726	281	3,391	8,296
AQ5	1,016	81	201	1,447	2,115	4,860	8,270
AQ6	134	46	71	653	166	1,070	2,548
AQ7	150	29	44	375	259	857	2,181
AQ8	2	1	10	118	272	403	1,448
AQ9	104	8	39	110	189	450	2,030
AQ10	170	11	52	353	995	1,581	2,026
Accruing past due	—	—	—	—	—	—	40
	35,008	11,582	19,049	142,264	219,174	427,077	438,199
RFS MI						—	3,255
Group						427,077	441,454
Counterparty mtm netting						(330,397)	(358,917)
Cash collateral held against derivative exposures (1)						(31,096)	(33,667)
Net exposure						65,584	48,870

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

Contract type	0-3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Total £m	Counterparty mtm netting £m	Net exposure £m
2010								
Exchange rate	28,938	7,820	9,360	23,174	13,961	83,253	(69,509)	13,744
Interest rate	4,822	3,533	7,927	104,026	191,423	311,731	(236,513)	75,218
Credit derivatives	497	99	313	12,374	13,589	26,872	(22,728)	4,144
Equity and commodity	751	130	1,449	2,690	201	5,221	(1,647)	3,574
	35,008	11,582	19,049	142,264	219,174	427,077	(330,397)	96,680
Cash collateral held against derivative exposures (1)								(31,096)
Net exposure								65,584

2009								
Exchange rate	19,127	5,824	7,603	23,831	11,967	68,352	(47,885)	20,467
Interest rate	8,415	8,380	16,723	111,144	176,799	321,461	(270,791)	50,670
Credit derivatives	201	112	390	19,859	21,186	41,748	(36,411)	5,337
Equity and commodity	1,562	436	1,109	3,057	474	6,638	(3,830)	2,808
	29,305	14,752	25,825	157,891	210,426	438,199	(358,917)	79,282
RFS MI						3,255	—	3,255
Group						441,454	(358,917)	82,537
Cash collateral held against derivative exposures (1)								(33,667)
Net exposure								48,870

Note:

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

Risk management: Credit risk continued
Balance sheet analysis: Derivatives continued

Contract type	0-3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	Over 5 years £m	Gross assets £m	Counterparty mtm netting £m	Net exposure £m
2008								
Exchange rate	65,428	21,106	25,150	43,860	17,339	172,883	(113,451)	59,432
Interest rate	14,195	17,364	23,603	193,254	405,926	654,342	(597,482)	56,860
Credit derivatives	932	384	2,511	83,599	54,940	142,366	(112,119)	30,247
Equity and commodity	4,807	2,864	5,579	8,069	585	21,904	(10,645)	11,259
	85,362	41,718	56,843	328,782	478,790	991,495	(833,697)	157,798
RFS MI						1,064	—	1,064
Group						992,559	(833,697)	158,862

Key points

- Whilst gross exchange rate contracts increased due to the trading fluctuations and favourable movements in forward rates and volume, the mix in counterparty netting arrangements reduced the net exposure.

- In a year of significant quarterly interest rate volatility, the overall annual interest rate trend was downwards, with all major rate indices moving down by at least 30 basis points in the medium to long end, with USD and GBP dropping approximately 70 basis points in the 5 year yield curve. The increase in gross asset values caused by the drop in interest rates was offset by the greater use of London Clearing House (LCH) as a counterparty, up from 56% at the end of 2009 to 60% by end of 2010. Reduction in non-LCH related netting increased the net exposure, excluding the effect of collateral arrangements. *

- The reduction in credit derivatives primarily reflected the APS credit derivative reducing from £1.4 billion at the start of the year to £550 million at end of 2010. The effect of credit spread widening in GBM and Non-Core were offset by portfolio reductions, as part of de-risking, and currency movements.

Cross border exposures

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

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

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

	2010				2009	2008
	Government £m	Banks £m	Other £m	Total £m	Total £m	Total £m
United States	21,201	14,382	36,813	72,396	74,409	91,544
France	17,293	16,007	6,756	40,056	37,489	58,251
Germany	22,962	6,276	10,467	39,705	41,727	40,812

Japan	7,983	6,962	7,542	22,487	18,939	14,933
Spain	1,401	4,248	11,589	17,238	27,118	36,441
Netherlands	2,900	3,055	10,824	16,779	20,262	34,283
Italy	6,409	1,083	2,188	9,680	14,412	16,582
Cayman Islands	2	94	7,330	7,426	10,786	18,126
Republic of Ireland	199	3,789	3,101	7,089	14,902	18,662
Belgium	1,461	752	2,806	5,019	9,340	16,313

*unaudited

Risk management: Credit risk continued

REIL, provisions and reserves
All the disclosures in this section (pages 121 to 132) are audited. The Group classifies impaired assets as either risk elements in lending (REIL) or potential problem loans (PPL). REIL represents impaired loans, and loans that are accruing but are past due 90 days. PPL represents impaired assets which are not included in REIL, but where information about possible credit problems cause management to have serious doubts about the future ability of the borrower to comply with loan repayment terms.

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

The analysis of risk elements in lending and impairments below, form a key part of the data provided to senior management on the credit performance of the Group's portfolios.

The table below analyses the Group's REIL and PPL and takes no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provisions.

	2010			2009					2008	
	Core	Non-Core	Group	Core	Non-Core	Group before RFS MI	RFS MI	Group	Group before RFS MI	Group
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Impaired loans (1)										
UK	7,903	7,835	15,738	6,558	7,311	13,869	3	13,872	8,724	8,733
Overseas	5,608	14,355	19,963	4,173	13,769	17,942	3,211	21,153	8,358	10,746
	13,511	22,190	35,701	10,731	21,080	31,811	3,214	35,025	17,082	19,479
Accruing loans past due 90 days or more (2)										
UK	1,434	939	2,373	1,146	1,089	2,235	—	2,235	1,201	1,201
Overseas	262	262	524	212	731	943	46	989	508	581
	1,696	1,201	2,897	1,358	1,820	3,178	46	3,224	1,709	1,782
Total REIL	15,207	23,391	38,598	12,089	22,900	34,989	3,260	38,249	18,791	21,261
Potential problem loans (3)	473	160	633	272	652	924	85	1,009	226	226
Total REIL and PPL	15,680	23,551	39,231	12,361	23,552	35,913	3,345	39,258	19,017	21,487
REIL as a % of gross loans to customers (4)	3.7%	20.7%	7.3%	2.8%	15.1%	6.1%	2.4%	5.4%	2.7%	2.5%

REIL and PPL as a % of gross loans to customers (4)	3.8%	20.8%	7.4%	2.9%	15.5%	6.2%	2.5%	5.5%	2.7%	2.5%
Closing provision for impairment as a % of total REIL	51%	44%	47%	56%	37%	44%	65%	46%	50%	52%
Closing provision for impairment as a % of total REIL and PPL	49%	44%	46%	55%	36%	43%	63%	45%	50%	51%

Notes:

(1) All loans against which an impairment provisions is held.

(2) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.

(3) Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for advances and revolving credit facilities where the past due concept is not applicable.

(4) Includes gross loans relating to disposal groups but excludes reverse repos.

Risk management: Credit risk continued
REIL, provisions and reserves continued
Movement in REIL and PPL
The table below details the movement in REIL and PPL during the year ended 31 December 2010.

	REIL			PPL			Total		
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	Total £m
At 1 January 2010	12,089	22,900	34,989	272	652	924	12,361	23,552	35,913
Intra-group transfers	(142)	142	—	147	(147)	—	5	(5)	—
Currency translation and other adjustments	22	(124)	(102)	(1)	2	1	21	(122)	(101)
Additions	11,435	11,915	23,350	1,539	502	2,041	12,974	12,417	25,391
Transfers	69	(185)	(116)	(85)	(61)	(146)	(16)	(246)	(262)
Disposals, restructurings and repayments	(5,385)	(6,694)	(12,079)	(1,399)	(788)	(2,187)	(6,784)	(7,482)	(14,266)
Amounts written-off	(2,881)	(4,563)	(7,444)	—	—	—	(2,881)	(4,563)	(7,444)
At 31 December 2010	15,207	23,391	38,598	473	160	633	15,680	23,551	39,231

Key points

- REIL increased by £3.1 billion or 26% in Core reflecting net increases in impaired loans in UK Corporate (£1.6 billion) and Ulster Bank (£1.4 billion).

- In UK Corporate impaired loans increased reflecting a number of specific cases which resulted in REIL/PPL as a % of loans increasing from 2.2% to 3.7%.

- Provisions, REIL and related coverage ratios in Ulster Bank increased reflecting a deterioration in customer credit quality due to a fall in Irish property prices.

- In US Retail & Commercial, impairment losses declined following a gradual improvement in the underlying credit environment, throughout 2010.

- Increase in provisions and related REIL in Non-Core reflected difficult conditions in specific sectors, particularly UK and Irish commercial property.

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

	2010			2009					2008
						Group before			
	Core £m	Non-Core £m	Total £m	Core £m	Non-Core £m	RFS MI £m	RFS MI £m	Group £m	Group £m

Past due 1-29 days	6,401	822	7,223	5,101	1,486	6,587	1,209	7,796	9,517
Past due 30-59 days	1,725	392	2,117	1,943	357	2,300	424	2,724	2,941
Past due 60-89 days	922	271	1,193	2,203	207	2,410	177	2,587	1,427
Past due 90 days or more	1,696	1,201	2,897	1,358	1,820	3,178	46	3,224	1,782
	10,744	2,686	13,430	10,605	3,870	14,475	1,856	16,331	15,667

Note:

(1) The amounts shown above include loans and advances to customers that are past due through administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

*unaudited

Risk management: Credit risk continued
REIL, provisions and reserves continued

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

2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Total Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Central and local government	8,452	—	—	—	—	—	—	—
Finance								
- banks	58,036	145	127	0.2	88	0.2	(13)	12
- other	54,561	1,129	595	2.1	53	1.1	198	141
Residential mortgages	146,501	4,276	877	2.9	21	0.6	1,014	669
Personal lending	37,472	3,544	2,894	9.5	82	7.7	1,370	1,577
Property	90,106	19,584	6,736	21.7	34	7.5	4,682	1,009
Construction	12,032	2,464	875	20.5	36	7.3	530	146
Manufacturing	32,317	1,199	503	3.7	42	1.6	(92)	1,547
Service industries and business activities	117,510	5,258	2,285	4.5	43	1.9	1,293	822
Agriculture, forestry and fishing	3,893	152	86	3.9	57	2.2	31	6
Finance leases and instalment credit	16,850	847	554	5.0	65	3.3	252	113
Interest accruals	1,109	—	—	—	—	—	—	—
Latent	—	—	2,650	—	—	—	(121)	—
	578,839	38,598	18,182	6.7	47	3.1	9,144	6,042
of which:								
UK	382,609	18,111	8,537	4.7	47	2.2	3,912	2,271
Europe	94,119	16,436	7,270	17.5	44	7.7	3,878	1,663
US	75,430	2,330	1,643	3.1	71	2.2	1,020	1,660
RoW	26,681	1,721	732	6.5	43	2.7	334	448
Group before RFS MI	578,839	38,598	18,182	6.7	47	3.1	9,144	6,042
RFS MI	2	—	—	—	—	—	42	—
Group	578,841	38,598	18,182	6.7	47	3.1	9,186	6,042

Risk management: Credit risk continued

REIL, provisions and reserves continued

Loans, REIL and impairments by industry and geography continued

2009	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Total Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Central and local government	7,660	—	—	—	—	—	—	—
Finance								
- banks	48,934	206	157	0.4	76	0.3	34	—
- other	60,386	1,539	419	2.5	27	0.7	886	692
Residential mortgages	140,907	3,284	551	2.3	17	0.4	909	642
Personal lending	41,671	3,940	2,926	9.5	74	7.0	2,517	2,002
Property	99,426	14,318	3,422	14.4	24	3.4	3,296	650
Construction	14,760	2,232	519	15.1	23	3.5	479	287
Manufacturing	44,674	3,131	2,088	7.0	67	4.7	1,520	784
Service industries and business activities	134,076	5,308	1,860	4.0	35	1.4	1,964	1,281
Agriculture, forestry and fishing	4,279	137	73	3.2	53	1.7	30	5
Finance leases and instalment credit	20,103	894	418	4.4	47	2.1	271	135
Interest accruals	1,728	—	—	—	—	—	—	—
Latent	—	—	2,740	—	—	—	1,184	—
	618,604	34,989	15,173	5.7	43	2.5	13,090	6,478
of which:								
UK	394,297	16,104	6,922	4.1	43	1.8	5,593	2,924
Europe	107,803	13,390	5,449	12.4	41	5.1	3,270	427
US	84,072	4,115	2,020	4.9	49	2.4	3,273	2,656
RoW	32,432	1,380	782	4.3	57	2.4	954	471
Group before RFS MI	618,604	34,989	15,173	5.7	43	2.5	13,090	6,478
RFS MI	142,688	3,260	2,110	2.3	65	1.5	1,044	461
Group	761,292	38,249	17,283	5.0	45	2.3	14,134	6,939

Risk management: Credit risk continued
REIL, provisions and reserves continued
Loans, REIL and impairments by industry and geography continued

	Core							
2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Central and local government	6,781	—	—	—	—	—	—	—
Finance								
- banks	57,033	144	126	0.3	88	0.2	(5)	1
- other	46,910	567	402	1.2	71	0.9	191	53
Residential mortgages	140,359	3,999	693	2.8	17	0.5	578	243
Personal lending	33,581	3,131	2,545	9.3	81	7.6	1,157	1,271
Property	42,455	3,287	818	7.7	25	1.9	739	98
Construction	8,680	610	222	7.0	36	2.6	189	38
Manufacturing	25,797	555	266	2.2	48	1.0	119	124
Service industries and business activities	95,127	2,576	948	2.7	37	1.0	687	349
Agriculture, forestry and fishing	3,758	94	57	2.5	61	1.5	24	5
Finance leases and instalment credit	8,321	244	140	2.9	57	1.7	63	42
Interest accruals	831	—	—	—	—	—	—	—
Latent	—	—	1,649	—	—	—	(5)	—
	469,633	15,207	7,866	3.2	52	1.7	3,737	2,224
of which:								
UK	319,679	9,337	4,797	2.9	51	1.5	2,234	1,519
Europe	65,874	3,905	2,027	5.9	52	3.1	936	111
US	62,085	1,027	824	1.7	80	1.3	425	556
RoW	21,995	938	218	4.3	23	1.0	142	38
Group before RFS MI	469,633	15,207	7,866	3.2	52	1.7	3,737	2,224
2009								
Central and local government	6,128	—	—	—	—	—	—	—
Finance								
- banks	47,574	168	135	0.4	80	0.3	12	—
- other	50,673	1,038	259	2.0	25	0.5	256	113
Residential mortgages	127,975	2,670	341	2.1	13	0.3	305	146
Personal lending	35,313	3,344	2,560	9.5	77	7.2	1,816	1,398
Property	49,054	1,766	468	3.6	27	1.0	417	37
Construction	9,502	457	131	4.8	29	1.4	58	30
Manufacturing	30,272	491	191	1.6	39	0.6	136	93
Service industries and business activities	100,438	1,762	669	1.8	38	0.7	500	365

Agriculture, forestry and fishing	3,726	90	46	2.4	51	1.2	24	4
Finance leases and instalment credit	8,147	303	116	3.7	38	1.4	52	100
Interest accruals	1,179	—	—	—	—	—	—	—
Latent	—	—	2,005	—	—	—	991	—
	469,981	12,089	6,921	2.6	57	1.5	4,567	2,286
of which:								
UK	315,254	7,704	4,209	2.4	55	1.3	2,884	1,645
Europe	66,707	2,607	1,709	3.9	66	2.6	750	46
US	64,526	1,497	876	2.3	59	1.4	813	576
RoW	23,494	281	127	1.2	45	0.5	120	19
Group before RFS MI	469,981	12,089	6,921	2.6	57	1.5	4,567	2,286

Risk management: Credit risk continued
REIL, provisions and reserves continued
Loans, REIL and impairments by industry and geography continued

Non-Core	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
2010								
Central and local government	1,671	—	—	—	—	—	—	—
Finance								
- banks	1,003	1	1	0.1	100	0.1	(8)	11
- other	7,651	562	193	7.3	34	2.5	7	88
Residential mortgages	6,142	277	184	4.5	66	3.0	436	426
Personal lending	3,891	413	349	10.6	85	9.0	213	306
Property	47,651	16,297	5,918	34.2	36	12.4	3,943	911
Construction	3,352	1,854	653	55.3	35	19.5	341	108
Manufacturing	6,520	644	237	9.9	37	3.6	(211)	1,423
Service industries and business activities	22,383	2,682	1,337	12.0	50	6.0	606	473
Agriculture, forestry and fishing	135	58	29	43.0	50	21.5	7	1
Finance leases and instalment credit	8,529	603	414	7.1	69	4.9	189	71
Interest accruals	278	—	—	—	—	—	—	—
Latent	—	—	1,001	—	—	—	(116)	—
	109,206	23,391	10,316	21.4	44	9.4	5,407	3,818
of which:								
UK	62,930	8,774	3,740	13.9	43	5.9	1,678	752
Europe	28,245	12,531	5,243	44.4	42	18.6	2,942	1,552
US	13,345	1,303	819	9.8	63	6.1	595	1,104
RoW	4,686	783	514	16.7	66	11.0	192	410
Group before RFS MI	109,206	23,391	10,316	21.4	44	9.4	5,407	3,818
2009								
Central and local government	1,532	—	—	—	—	—	—	—
Finance								
- banks	1,360	38	22	2.8	58	1.6	22	—
- other	9,713	501	160	5.2	32	1.6	630	579
Residential mortgages	12,932	614	210	4.7	34	1.6	604	496
Personal lending	6,358	596	366	9.4	61	5.8	701	604
Property	50,372	12,552	2,954	24.9	24	5.9	2,879	613
Construction	5,258	1,775	388	33.8	22	7.4	421	257
Manufacturing	14,402	2,640	1,897	18.3	72	13.2	1,384	691
Service industries and business activities	33,638	3,546	1,191	10.5	34	3.5	1,464	916

Agriculture, forestry and fishing	553	47	27	8.5	57	4.9	6	1
Finance leases and instalment credit	11,956	591	302	4.9	51	2.5	219	35
Interest accruals	549	—	—	—	—	—	—	—
Latent	—	—	735	—	—	—	193	—
	148,623	22,900	8,252	15.4	36	5.6	8,523	4,192
of which:								
UK	79,043	8,400	2,713	10.6	32	3.4	2,709	1,279
Europe	41,096	10,783	3,740	26.2	35	9.1	2,520	381
US	19,546	2,618	1,144	13.4	44	5.9	2,460	2,080
RoW	8,938	1,099	655	12.3	60	7.3	834	452
Group before RFS MI	148,623	22,900	8,252	15.4	36	5.6	8,523	4,192

Risk management: Credit risk continued
REIL, provisions and reserves continued

Risk elements in lending and potential problem loans by division
The tables below analyse the Group's loans and advances to banks and customers (excluding reverse repos and disposal groups) and related REIL, PPL, provisions, impairments, amounts written-off and related ratios by division.

2010	Gross loans £m	REIL £m	PPL £m	REIL & PPL £m	Provisions £m	Provisions as % of REIL %	Provisions as % of REIL & PPL %	REIL & PPL as a % of gross loans %	Impairment charge £m	Amounts written-off £m
UK Retail	108,813	4,620	175	4,795	2,741	59	57	4.4	1,160	1,135
UK Corporate	111,744	3,967	221	4,188	1,732	44	41	3.7	761	349
Wealth	18,350	223	38	261	66	30	25	1.4	18	9
Global Transaction Services	17,484	146	6	152	147	101	97	0.9	8	49
Ulster Bank	39,786	3,619	2	3,621	1,633	45	45	9.1	1,161	48
US Retail & Commercial	48,661	913	—	913	505	55	55	1.9	483	547
Retail & Commercial	344,838	13,488	442	13,930	6,824	51	49	4.0	3,591	2,137
Global Banking & Markets	122,054	1,719	31	1,750	1,042	61	60	1.4	146	87
RBS Insurance and other	2,741	—	—	—	—	—	—	—	—	—
Core	469,633	15,207	473	15,680	7,866	52	50	3.3	3,737	2,224
Non-Core	109,206	23,391	160	23,551	10,316	44	44	21.6	5,407	3,818
Group before RFS MI	578,839	38,598	633	39,231	18,182	47	46	6.8	9,144	6,042
RFS MI	2	—	—	—	—	—	—	—	42	—
Group	578,841	38,598	633	39,231	18,182	47	46	6.8	9,186	6,042
2009										
UK Retail	103,812	4,641	—	4,641	2,677	58	58	4.5	1,679	1,150
UK Corporate	111,671	2,330	97	2,427	1,271	55	52	2.2	923	352
Wealth	15,525	218	38	256	55	25	21	1.6	33	12
Global Transaction Services	14,146	197	4	201	189	96	94	1.4	39	23
Ulster Bank	42,344	2,260	2	2,262	962	43	43	5.3	649	34
US Retail & Commercial	48,937	643	—	643	478	74	74	1.3	702	546
Retail & Commercial	336,435	10,289	141	10,430	5,632	55	54	3.1	4,025	2,117
Global Banking & Markets	130,898	1,800	131	1,931	1,289	72	67	1.5	542	169
	2,648	—	—	—	—	—	—	—	—	—

RBS Insurance and other										
Core	469,981	12,089	272	12,361	6,921	57	56	2.6	4,567	2,286
Non-Core	148,623	22,900	652	23,552	8,252	36	35	15.8	8,523	4,192
Group before RFS MI	618,604	34,989	924	35,913	15,173	43	42	5.8	13,090	6,478
RFS MI	142,688	3,260	85	3,345	2,110	65	63	2.3	1,044	461
Group	761,292	38,249	1,009	39,258	17,283	45	44	5.2	14,134	6,939
2008										
UK Retail	94,565	3,832	—	3,832	2,086	54	54	4.1	1,019	823
UK Corporate	117,036	1,254	74	1,328	696	56	52	1.1	319	377
Wealth	14,033	107	24	131	34	32	26	0.9	15	8
Global Transaction Services	16,950	53	—	53	43	81	81	0.3	48	15
Ulster Bank	46,628	1,196	1	1,197	491	41	41	2.6	106	20
US Retail & Commercial	62,168	424	—	424	298	70	70	0.7	437	312
Retail & Commercial	351,380	6,866	99	6,965	3,648	53	52	2.0	1,944	1,555
Global Banking & Markets	227,116	869	18	887	621	71	70	0.4	306	343
RBS Insurance and other	6,401	—	—	—	—	—	—	—	—	80
Core	584,897	7,735	117	7,852	4,269	55	54	1.3	2,250	1,978
Non-Core	187,258	11,056	109	11,165	5,182	47	46	6.0	4,228	919
Group before RFS MI	772,155	18,791	226	19,017	9,451	50	50	2.5	6,478	2,897
RFS MI	153,696	2,470	—	2,470	1,565	63	63	1.6	613	251
Group	925,851	21,261	226	21,487	11,016	52	51	2.3	7,091	3,148

Risk management: Credit risk continued
REIL, provisions and reserves continued

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

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

- Collectively assessed provisions: provisions on impaired credits below an agreed threshold which are assessed on a portfolio basis, to reflect the homogeneous nature of the assets, such as credit cards or personal loans. The provision is determined from a quantitative review of the relevant portfolio, taking account of the level of arrears, security and average loss experience over the recovery period. It incorporates loss experience adjustments, where appropriate, in the light of current economic and credit conditions. These include review of current cash collections profile performance against historic trends, updates to metric inputs - including model recalibrations and monitoring of operational processes used in managing exposure - including the time taken to process non-performing exposures; and

- Latent loss provisions: provisions held against impairments in the performing portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date. The Group has developed methodologies to estimate latent loss provisions that reflect:

  – historical loss experience adjusted where appropriate, in the light of current economic and credit conditions; and

  – the period ('emergence period') between an impairment event occurring and a loan being identified and reported as impaired.

- Recoverable cash flows or proceeds are estimated using two parameters: loss given default (LGD) - this is the estimated loss amount, expressed as a percentage, that will be incurred if the borrower defaults; and the probability that the borrower will default (PD).

- Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as a coupon period and repayment terms, and the duration of the administrative process required to report and identify an impaired loan as such. Emergence periods vary across different portfolios from 2 to 225 days. They are based on actual experience within the particular portfolio and are reviewed regularly.

- The Group's retail business segment their performing loan books into homogenous portfolios such as mortgages, credit cards or unsecured loans, to reflect their different credit characteristics. Latent provisions are computed by applying portfolio-level LGDs, PDs and emergence periods. The wholesale calculation is based on similar principles but there is no segmentation into portfolios: PDs and LGDs are calculated on an individual basis.

- Once a loss event has occurred, a loan is assessed for an impairment provision. In the case of loans that are restructured due to the financial condition of the borrower, the loss event and consequent loan impairment provision assessment (based on management’s best estimate of the incurred loss) almost invariably take place prior to the restructuring. The quantum of the loan impairment provision may change once the terms of the restructuring are known resulting in an additional provision charge or a release of provision in the period in which the restructuring takes place.

Provisions and AFS reserves

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

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

Analyses of provisions are set out on page 129.

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

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

Analyses of AFS debt securities and related AFS reserves are set out on pages 131 and 132.

Risk management: Credit risk continued
REIL, provisions and reserves continued

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

2010	UK Retail £m	UK Corporate £m	Wealth £m	GTS (1) £m	Ulster Bank £m	US R&C (2) £m	Total R&C (2) £m	GBM (3) £m	Total Core £m	Non-Core £m	RFS MI £m	Group £m
At 1 January	2,677	1,271	55	189	962	478	5,632	1,289	6,921	8,252	2,110	17,283
Intra-group transfers	—	—	—	—	(351)	—	(351)	(217)	(568)	568	—	—
Transfer to disposal groups	—	—	—	—	—	—	—	—	—	(72)	—	(72)
Currency translation and other adjustments	—	71	4	(2)	(22)	19	70	(86)	(16)	59	—	43
Disposal of subsidiaries	—	—	—	—	—	—	—	—	—	(20)	(2,152)	(2,172)
Amounts written-off	(1,135)	(349)	(9)	(49)	(48)	(547)	(2,137)	(87)	(2,224)	(3,818)	—	(6,042)
Recoveries of amounts previously written-off	128	8	—	1	1	72	210	3	213	198	—	411
Charged to the income statement												
- continuing operations	1,160	761	18	8	1,161	483	3,591	146	3,737	5,407	—	9,144
- discontinued operations	—	—	—	—	—	—	—	—	—	—	42	42
Unwind of discount	(89)	(30)	(2)	—	(70)	—	(191)	(6)	(197)	(258)	—	(455)
At 31 December	2,741	1,732	66	147	1,633	505	6,824	1,042	7,866	10,316	—	18,182
Individually assessed												
- banks	—	—	2	7	—	—	9	117	126	1	—	127
- customers	—	546	57	111	502	56	1,272	676	1,948	8,161	—	10,109
Collectively assessed	2,526	689	—	14	733	177	4,139	—	4,139	1,157	—	5,296
Latent	215	497	7	15	398	272	1,404	249	1,653	997	—	2,650
	2,741	1,732	66	147	1,633	505	6,824	1,042	7,866	10,316	—	18,182
2009												
At 1 January	2,086	696	34	43	491	298	3,648	621	4,269	5,182	1,565	11,016
Transfer to disposal groups	—	—	—	—	—	—	—	(16)	(16)	(305)	(3)	(324)
Currency translation and other adjustments	67	5	1	128	(109)	(34)	58	365	423	(851)	(102)	(530)
Disposal of subsidiaries	—	—	—	—	—	—	—	(62)	(62)	(3)	—	(65)
Amounts written-off	(1,150)	(352)	(12)	(23)	(34)	(546)	(2,117)	(169)	(2,286)	(4,192)	(461)	(6,939)
	97	20	—	2	1	58	178	11	189	136	74	399

Recoveries of amounts previously written-off												
Charged to the income statement												
- continuing operations	1,679	923	33	39	649	702	4,025	542	4,567	8,523	—	13,090
- discontinued operations	—	—	—	—	—	—	—	—	—	—	1,044	1,044
Unwind of discount	(102)	(21)	(1)	—	(36)	—	(160)	(3)	(163)	(238)	(7)	(408)
At 31 December	2,677	1,271	55	189	962	478	5,632	1,289	6,921	8,252	2,110	17,283
Individually assessed												
- banks	—	—	2	8	—	—	10	125	135	22	—	157
- customers	—	205	44	156	280	14	699	573	1,272	6,229	1,295	8,796
Collectively assessed	2,475	475	—	17	412	130	3,509	—	3,509	1,266	479	5,254
Latent	202	591	9	8	270	334	1,414	591	2,005	735	336	3,076
	2,677	1,271	55	189	962	478	5,632	1,289	6,921	8,252	2,110	17,283

Notes:

(1) Global Transaction Services.

(2) Retail & Commercial.

(3) Global Banking & Markets.

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Risk management: Credit risk continued
REIL, provisions and reserves continued

Analysis of loan impairment charge
The following table analyses impairment losses.

	2010	2009	2008
	£m	£m	£m
Latent loss	(121)	1,184	769
Collectively assessed	3,070	3,994	2,391
Individually assessed	6,208	7,878	3,200
Loans to customers	9,157	13,056	6,360
Loans to banks	(13)	34	118
Securities	112	809	961
Charge to income statement	9,256	13,899	7,439
Charge relating to customer loans as a % of gross customer loans (1)	1.7%	2.3%	0.9%

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

	2010			2009			2008
	Core	Non-Core	Group	Core	Non-Core	Group	Group
	£m	£m	£m	£m	£m	£m	£m
Loan impairment losses							
- customers	3,742	5,415	9,157	4,555	8,501	13,056	6,360
- banks	(5)	(8)	(13)	12	22	34	118
	3,737	5,407	9,144	4,567	8,523	13,090	6,478
Impairment losses on securities							
- debt securities	40	41	81	98	503	601	858
- equity securities	4	27	31	13	195	208	103
	44	68	112	111	698	809	961
Charge to income statement	3,781	5,475	9,256	4,678	9,221	13,899	7,439

Key point
- Provisions are 3.44% of loans and advances at 31 December 2010, compared with 2.69% at 31 December 2009. Non-Core figures were 9.14% versus 5.79%.

Risk management: Credit risk continued
REIL, provisions and reserves continued

Available-for-sale debt securities and related reserves
The table below analyses available-for-sale (AFS) debt securities by issuer and related AFS reserves, for countries exceeding £0.5 billion at any reporting date below, together with the total of those individually less than £0.5 billion.

	2010					2009				
	Government £m	ABS £m	Other £m	Total £m	AFS reserves £m	Government £m	ABS £m	Other £m	Total £m	AFS reserves £m
US	17,890	20,872	763	39,525	(116)	12,789	24,788	668	38,245	(302)
UK	8,377	4,002	2,284	14,663	(106)	18,350	4,372	3,267	25,989	(169)
Germany	10,653	1,360	535	12,548	(35)	12,283	1,036	406	13,725	(24)
Netherlands	3,469	6,773	713	10,955	(59)	4,329	7,522	1,558	13,409	(115)
France	5,912	575	900	7,387	33	6,456	543	812	7,811	9
Spain	88	6,773	169	7,030	(939)	162	8,070	355	8,587	(117)
Japan	4,354	—	82	4,436	—	1,426	—	100	1,526	(7)
Australia	—	486	1,586	2,072	(34)	—	581	1,213	1,794	(85)
Italy	906	243	24	1,173	(86)	1,007	380	72	1,459	(39)
Belgium	763	34	243	1,040	(34)	788	34	397	1,219	(24)
Hong Kong	905	—	8	913	—	975	—	—	975	—
Greece	895	—	—	895	(517)	1,389	—	—	1,389	(196)
Singapore	649	—	209	858	—	564	13	105	682	—
Switzerland	657	—	156	813	11	653	—	28	681	11
Denmark	629	—	172	801	2	659	—	256	915	2
South Korea	261	429	—	690	(2)	—	526	—	526	(3)
Republic of Ireland	104	177	408	689	(74)	150	529	319	998	(154)
India	548	—	139	687	2	480	—	—	480	3
Luxembourg	253	78	226	557	20	—	222	307	529	11
Austria	274	51	152	477	(20)	249	202	142	593	(17)
Portugal	92	106	43	241	(36)	552	125	45	722	(18)
Other (individually < £0.5 billion)	1,710	556	414	2,680	(71)	1,605	1,521	2	3,128	(654)
Group before RFS MI	59,389	42,515	9,226	111,130	(2,061)	64,866	50,464	10,052	125,382	(1,888)
RFS MI	—	—	—	—	—	12,689	580	4,647	17,916	170
Group	59,389	42,515	9,226	111,130	(2,061)	77,555	51,044	14,699	143,298	(1,718)

Key points
- Exposure to Spain reduced by £1.6 billion during 2010, largely in residential mortgage-backed covered bond exposures to financial institutions.

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Italian exposures declined by £0.3 billion during 2010 from a combination of reductions in corporate clients and financial institutions, primarily in GBM.

- The £500 million reductions in both Greek and Portuguese exposures primarily reflect disposals.

Risk management: Credit risk continued
REIL, provisions and reserves continued

Available-for-sale debt securities: gross unrealised losses
The table below shows the fair value of available-for-sale debt securities that were in an unrealised loss position at 31 December, and the related gross unrealised losses.

	Less than 12 months		More than 12 months		Total	
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses
2010	£m	£m	£m	£m	£m	£m
UK central and local government	716	10	—	—	716	10
US central and local government	51	1	4	—	55	1
Other central and local government	4,327	6	1,737	612	6,064	618
Banks and building societies	1,649	16	462	16	2,111	32
Asset backed securities	2,519	101	12,867	3,296	15,386	3,397
Corporate	204	4	108	32	312	36
Other	463	—	11	3	474	3
	9,929	138	15,189	3,959	25,118	4,097
2009						
UK central and local government	2,727	57	26	—	2,753	57
US central and local government	5,349	88	7	1	5,356	89
Other central and local government	5,863	203	391	6	6,254	209
Banks and building societies	8,421	56	827	6	9,248	62
Asset backed securities	3,185	983	23,832	2,330	27,017	3,313
Corporate	384	14	166	34	550	48
Other	710	3	16	3	726	6
Group before RFS MI	26,639	1,404	25,265	2,380	51,904	3,784
RFS MI	1,890	64	161	62	2,051	126
Group	28,529	1,468	25,426	2,442	53,955	3,910
2008						
US central and local government	260	3	4,770	163	5,030	166
Other central and local government	13,341	555	39	6	13,380	561
Banks and building societies	1,402	95	1,168	49	2,570	144
Asset backed securities	15,032	2,432	25,033	693	40,065	3,125
Corporate	618	267	2,325	136	2,943	403
Other	9	1	235	78	244	79
Group before RFS MI	30,662	3,353	33,570	1,125	64,232	4,478
RFS MI	4,598	3,303	6,032	49	10,630	3,352
Group	35,260	6,656	39,602	1,174	74,862	7,830

Market risk

All the disclosures in this section (pages 133 to 138) are audited unless indicated otherwise with an asterisk (*).

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities. The Group manages market risk centrally within its trading and non-trading portfolios through a comprehensive market risk management framework. This framework includes limits based on, but not limited to, value-at-risk (VaR), stress testing, positions and sensitivity analyses.

The majority of market risk exposure is in GBM and Non-Core. The Group is also exposed to market risk through interest rate risk on its non-trading activities. There are additional non-trading market risks in the Retail and Commercial businesses of the Group, principally interest rate risk and foreign exchange risk. These aspects are discussed in more detail in Balance sheet management - Interest rate risk on page 83 and structural foreign currency exposures on page 84.

Organisation and structure

The Executive Risk Forum approves market risk appetite for trading and non-trading activities. The Global Head of Market & Insurance Risk is responsible for the Group Market Risk Control Framework and under delegated authority from the Executive Risk Forum, sets a limit framework within the context of the approved market risk appetite, which is cascaded down through legal entity, division, business and desk level market risk limits.

A daily report summarises the Group's market risk exposures against agreed limits. This daily report is sent to the Head of Restructuring & Risk, Global Head of Market & Insurance Risk, business Chief Risk Officers and appropriate business Risk Managers.

The head of each business, assisted by the business risk management team, is accountable for all market risks associated with its activities. Oversight and support is provided to the business by the Global Head of Market & Insurance Risk, assisted by the Group and business Market Risk teams. The Global Market Risk Committee reviews and makes recommendations concerning the market risk profile across the Group, including risk appetite, limits and utilisation. The Committee meets monthly and is chaired by the Global Head of Market Risk & Insurance Risk. Attendees include respective business Risk Managers and Group Market Risk.

Risk measurement and control

At the Group level, the risk appetite is expressed in the form of a combination of VaR, sensitivity and stress testing limits. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group's VaR assumes a time horizon of one trading day and a confidence level of 99%. The Group's VaR model is based on a historical simulation model, utilising data from the previous two years.

The VaR model has been approved by the FSA to calculate regulatory capital for the trading book. The approval covers general market risk in interest rate, foreign exchange, equity and limited commodity products and specific risk in interest rate and equity products.

As the VaR model is an important market risk measurement and control tool and is used for determining a significant component of the market risk capital, it is regularly assessed. The main approach employed is the technique known as back-testing which counts the number of days when a loss (as defined by the FSA), exceeds the corresponding daily

VaR estimate, measured at a 99% confidence interval. The FSA categorises a VaR model as green, amber or red. A green model is consistent with a good working model and is achieved for models that have four or less back-testing exceptions in a 12 month period. For the Group's trading book, a green model status was maintained throughout 2010.

The Group's VaR should be interpreted in light of the limitations of the methodology used, as follows:

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the 500 trading day time series. Therefore, events that are more severe than those in the historical data series cannot be predicted.

- The use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile.

- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.

- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intra-day profit and losses will be incurred.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

A risk not in VaR framework has been developed to quantify those market risks not adequately captured by the market standard VaR methodology. Where risks are not included in the model, various non-VaR controls (for example, position monitoring, sensitivity limits, triggers or stress limits) are in place.

The Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of the Group's trading portfolios. The Group calculates historical stress tests and hypothetical stress tests.

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

Risk management: Market risk continued

Risk measurement and control continued

The Global Market Risk Stress Testing Committee reviews and discusses all matters relating to Market Risk Stress Testing. Stress test exposures are discussed with senior management and relevant information is reported to the Group Risk Committee, Executive Risk Forum and the Board. Breaches in the Group's market risk stress testing limits are monitored and reported.

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

Model validation governance

Pricing models are developed and owned by the front office. Where pricing models are used as the basis of books and records valuations, they are all subject to independent review and sign-off. Models are assessed by the Group Model Product Review Committee (GMPRC) as having either immaterial or material model risk (valuation uncertainty arising from choice of modelling assumptions), the assessment being made on the basis of expert judgement. Those models assessed as having material model risk are prioritised for independent quantitative review. Independent quantitative review aims to quantify model risk (i.e. the impact of missing risk factors in the front office model or the possibility that we may be mismarking these products relative to other market participants who may be using an alternative model) by comparing model outputs against alternative independently developed models. The results of the independent quantitative review are used by Market Risk to inform risk limits and by Finance to inform reserves. Governance over this process is provided by GMPRC, a forum which brings together Front Office Quantitative Analysts, Market Risk, Finance and Quantitative Research Centre (QuaRC), Group Risk's independent quantitative model review function.

Risk (market risk, incremental default risk, counterparty credit risk) models are developed both within business units and by Group functions. Risk models are also subject to independent review and sign-off. Meetings are held with the FSA every quarter to discuss the traded market risk, including changes in models, management, back testing results, risks not included in the VaR framework and other model performance statistics.

As part of the ongoing review and analysis of the suitability of the VaR model, a methodology enhancement to the ABS VaR was approved and incorporated into the regulatory model in 2010. The credit crisis in 2007 - 2009 caused large price changes for some structured bonds and the spread based approach to calculating VaR for these instruments started to give inaccurate risk levels, particularly for bonds trading at a significant discount to par. The methodology enhancement harmonised the VaR approach in the US and Europe by replacing the absolute spread-based approach with a more reliable and granular relative price-based mapping scheme. The enhancement better reflects the risk in the context of position changes, downgrades and vintage as well as improving differentiation between prime, Alt-A and sub-prime exposures.

The VaR disclosure is broken down into trading and non-trading portfolios. Trading VaR relates to the main trading activities of the Group and non-trading reflects the risk associated with reclassified assets, money market business and the management of internal funds flow within the Group's businesses.

Traded portfolios

The primary focus of the Group's trading activities is to provide an extensive range of debt and equity financing, risk management and investment services to its customers, including major corporations and financial institutions around the world. The Group undertakes these activities organised along six principal business lines: money markets; rates flow trading; currencies and commodities; equities; credit markets; and portfolio management & origination.

Financial instruments held in the Group's trading portfolios include, but are not limited to: debt securities, loans, deposits, equities, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options).

The Group participates in exchange traded and over-the-counter (OTC) derivatives markets. The Group buys and sells financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide margin daily with cash or other security at the exchange, to which the holders look for ultimate settlement.

The Group also buys and sells financial instruments that are traded OTC, rather than on a recognised exchange. These instruments range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to the requirements of the Group's customers. In many cases, industry standard documentation is used, most commonly in the form of a master agreement, with individual transaction confirmations.

Assets and liabilities in the trading book are measured at their fair value. Fair value is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair values are determined following IAS 39 guidance which requires banks to use quoted market prices or valuation techniques (models) that make the maximum use of observable inputs. When marking to market using a model, the valuation methodologies are reviewed and approved by the market risk function. Group Risk provides an independent evaluation of the model for transactions deemed by the Group Model Product Review Committee (GMPRC) to be large, complex and/or innovative. Any profits or losses on the revaluation of positions are recognised in the daily profit and loss.

Risk management: Market risk continued
Traded portfolios continued

The VaR for the Group's 2010 trading portfolios analysed by type of market risk exposure is shown below.

Daily VaR graph*

The Group has disclosed separately the Counterparty Exposure Management (CEM) trading book exposure and the exposure of Core without CEM. CEM manages the OTC derivative counterparty credit risk on behalf of GBM, by actively controlling risk concentrations and reducing unwanted risk exposures. The hedging transactions CEM enters into are booked in the trading book, and therefore contribute to the market risk VaR exposure of the Group. The counterparty exposures themselves are not captured in VaR for regulatory capital. In the interest of transparency and to more properly represent the trading book exposure, CEM trading book exposure is disclosed separately.

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

	2010				2009			
	Average	Period end	Maximum	Minimum	Average	Period end	Maximum	Minimum
Trading VaR	£m	£m	£m	£m	£m	£m	£m	£m
Interest rate	51.6	57.0	83.0	32.5	57.0	50.5	112.8	28.1
Credit spread	166.3	133.4	243.2	110.2	148.3	174.8	231.2	66.9
Currency	17.9	14.8	28.0	8.4	17.9	20.7	35.8	9.2
Equity	9.5	10.9	17.9	2.7	13.0	13.1	23.2	2.7
Commodity	9.5	0.5	18.1	0.5	14.3	8.9	32.1	6.5
Diversification		(75.6)				(86.1)		
	168.5	141.0	252.1	103.0	155.2	181.9	229.0	76.8
Core (Total)	103.6	101.2	153.4	58.3	101.5	127.3	137.8	54.8
CEM	53.3	54.6	82.4	30.3	29.7	38.6	41.3	11.5
Core excluding CEM	82.8	78.7	108.7	53.6	86.7	97.4	128.5	54.9
Non-Core	105.7	101.4	169.4	63.2	86.3	84.8	162.1	29.3

*unaudited

Risk management: Market risk continued
Traded portfolios continued

Key points

- The Group's period end VaR reduced as the exceptional volatility of the market data from the period of the financial crisis dropped out of the 500 days of time series data used in the VaR calculation. The credit spread VaR was particularly impacted as a result of this effect.

- The Group's maximum and average credit and Non-Core VaR were higher in 2010 than in 2009 due to Non-Core exiting several highly structured positions which, due to their complexity and layering, required unwinding with different counterparties over different periods. The timing of the unwind led to an increased VaR, until the exit was completed in October and the VaR then reduced back to the levels held earlier in the year.

- CEM VaR was greater in 2010 than 2009 due to the novation of counterparty risk hedging trades from RBS N.V. to RBS plc. For RBS N.V. there is no local regulatory requirement for counterparty hedges to be included in VaR, as they are treated on a standardised basis but on novation to CEM in RBS plc, under UK regulatory requirements, the trades were captured by the VaR model resulting in an increase in VaR.

- CEM trading VaR also increased as a consequence of the implementation of a discounting approach based on the real funding cost for the collateralised derivatives.

- Commodity VaR decreased during the year since a significant part of the Group's interest in RBS Sempra Commodities JV was sold during the year.

GBM traded revenue*

Key points*

- The average daily revenue earned from GBM's trading, balance sheet management and other trading activities in 2010 was £25.4 million compared with £37.8 million in 2009. The standard deviation of these daily revenues was £22.0 million compared with £32.3 million in 2009. The standard deviation measures the variation of daily revenues about the mean value of those revenues.

- An analysis of the frequency distribution of daily revenue shows that there were 22 days with negative revenue during 2010 compared with 16 days in 2009. The most frequent result is daily revenue of between £25 million and £30 million with 37 occurrences in 2010 compared with 26 occurrences in 2009.

- The effect of any month end adjustments, not attributable to a specific daily market move, is spread evenly over the days in the month in question.

- The graph of daily revenues for 2010 shows a narrower distribution of revenues compared with 2009.

* unaudited

Risk management: Market risk continued

Non-traded portfolios

VaR is not always the most appropriate measure of risk for assets in the non-trading book, particularly for those in Non-Core which will diminish over time as the asset inventory is sold down.

In order to better represent the risk of the non-traded portfolios, the table below analyses the VaR for the non-trading portfolios but excludes Structured Credit Portfolios (SCP) in Non-Core. These assets are shown separately on a drawn notional and fair value basis by maturity profile and asset class and are managed on both an asset and RWA basis.

Also excluded from the non-traded VaR are the loans and receivables products that are managed within the credit risk management framework. The 2009 and 2010 VaR data below is shown on this basis; however the VaR data for the 2008 period could not be recalculated excluding the SCP and LAR portfolios mentioned above due to data and system constraints.

The table below analyses the risk for the Group's non-trading portfolios.

	2010				2009			
	Average	Period end	Maximum	Minimum	Average	Period end	Maximum	Minimum
Non-trading VaR	£m	£m	£m	£m	£m	£m	£m	£m
Interest rate	8.7	10.4	20.5	4.4	13.0	13.9	26.3	7.7
Credit spread	32.0	16.1	101.2	15.4	81.7	100.3	131.5	39.7
Currency	2.1	3.0	7.6	0.3	1.4	0.6	7.0	0.2
Equity	1.2	3.1	4.6	0.2	3.3	2.2	5.8	1.6
Diversification		(15.9)				(20.4)		
	30.9	16.7	98.0	13.7	80.4	96.6	126.9	46.8
Core	30.5	15.6	98.1	12.8	78.4	95.9	126.9	46.8
Non-Core	1.3	2.8	4.1	0.2	3.5	1.9	16.9	—

Key points

- The non-traded credit spread, Core and total VaR have decreased significantly due to the implementation of the relative price-based mapping scheme in the VaR methodology discussed above and the sales of available-for-sale securities in the US mortgage business.

- The business model for the US mortgage business has focussed its activity on client facilitation flow trading during 2010. This has encompassed the disposal of a large portfolio of illiquid available-for-sale securities that were sold throughout the year, resulting in the non-traded VaR reducing. In parallel, the risk management of the business has been significantly enhanced to ensure that the business remains focussed on client facilitation flow trading of liquid assets. Tools have been implemented to monitor the liquidity of trading volumes, asset aged inventory controls have been tightened and granular asset concentration risk limits imposed, to complement the existing VaR and stress testing market risk frameworks.

Risk management: Market risk continued
Structured Credit Portfolios

	Drawn notional					Fair value				
			MBS	Other				MBS	Other	
	CDOs	CLOs	(1)	ABS	Total	CDOs	CLOs	(1)	ABS	Total
2010	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
1-2 years	—	—	—	47	47	—	—	—	42	42
2-3 years	85	19	44	98	246	81	18	37	91	227
3-4 years	—	41	20	205	266	—	37	19	191	247
4-5 years	16	—	—	—	16	15	—	—	—	15
5-10 years	98	466	311	437	1,312	87	422	220	384	1,113
>10 years	412	663	584	550	2,209	161	515	397	367	1,440
	611	1,189	959	1,337	4,096	344	992	673	1,075	3,084
2009										
1-2 years	—	—	—	81	81	—	—	—	68	68
2-3 years	40	—	—	19	59	24	—	—	18	42
3-4 years	19	18	42	99	178	16	17	31	76	140
4-5 years	17	47	36	332	432	3	41	29	275	348
5-10 years	107	685	424	521	1,737	90	594	251	394	1,329
>10 years	594	1,114	820	573	3,101	193	896	468	325	1,882
	777	1,864	1,322	1,625	5,588	326	1,548	779	1,156	3,809

Note:
(1) Mortgage-backed securities (MBS) include sub-prime residential mortgage-backed securities with a notional amount of £471 million (2009 - £682 million) and a fair value of £329 million (2009 - £415 million), all with residual maturities of greater than 10 years.

The SCP are within Non-Core. The risk on this portfolio is not measured or disclosed using VaR, as the Group believes this is not an appropriate tool for the banking book portfolio comprising of illiquid debt securities. The main driver of the reduction in drawn notional is the asset sales from a portfolio within an unwound securitisation arbitrage conduit. The impact of disposals on portfolio fair value has been partially offset by an increase in residual average price to 75% (2009 - 68%).

Risk management continued

All the disclosures in this section (pages 139 to 143) are unaudited and are marked with an asterisk (*).

Insurance risk*

Insurance risk arises through fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations at the time of underwriting. Insurance risk is managed in four distinct ways:

- underwriting and pricing risk management is managed through the use of underwriting guidelines which detail the class, nature and type of business that may be accepted, pricing policies by product line and brand, and centralised control of wordings and any subsequent changes;
- claims risk management is handled using a range of automated controls and manual processes;
- reserving risk management is applied to ensure that sufficient funds have been retained to handle and pay claims as the amounts fall due, both in relation to those claims which have already occurred or will occur in future periods of insurance. Reserving risk is managed through the detailed analysis of historical and industry claims data and robust control procedures around reserving models; and
- reinsurance risk management is used to protect against adverse claims experience on business which exceeds internal risk appetite. The Group uses various types of reinsurance to transfer risk that is outside the Group's risk appetite, including individual risk excess of loss reinsurance, catastrophe excess of loss reinsurance and quota share reinsurance.

Overall, insurance risk is predictable over time, given the large volumes of data. However, uncertainty does exist, especially around predictions such as the variations in weather for example. Risk is minimised through the application of documented insurance risk policies, coupled with risk governance frameworks and the purchase of reinsurance.

The Group underwrites retail and SME insurance with a focus on high volume, relatively straightforward products. The key insurance risks are as follows:

- motor insurance contracts (private and commercial): claims experience varies due to a range of factors, including age, gender and driving experience together with the type of vehicle and location;
- property insurance contracts (residential and commercial): the major causes of claims for property insurance are weather (flood, storm), theft, fire, subsidence and various types of accidental damage; and
- other commercial insurance contracts: risk arises from business interruption and loss arising from the negligence of the insured (liability insurance).

Most general insurance contracts are written on an annual basis, which means that the Group's liability extends for a twelve month period, after which the Group is entitled to decline to renew the policy or can impose renewal terms by amending the premium, terms and conditions.
An analysis of gross and net insurance claims can be found in the notes on the financial statements (see page 288).

Operational risk*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk is an integral and unavoidable part of the Group's business as it is inherent in the processes it operates in to provide services to customers and generate profit for shareholders. An objective of operational risk management is not to remove operational risk altogether, but to manage the risk to an acceptable level, taking into account the cost of minimising the risk as against the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

Group Policy Framework (GPF)
The GPF supports a consistent approach to how we do business and helps everyone understand their individual and collective responsibilities. It is a core component of the Group's Risk Appetite Framework; it supports the risk appetite setting process, and also underpins the control environment.

Work to design, implement and embed an enhanced GPF has continued throughout 2010 and will extend into 2011. The Group's plans for ongoing development of GPF will support increased consistency in risk appetite setting across all risk types faced by the Group, including alignment to the Group's strategic business and risk objectives. The Group will use relevant external reference points such as peers and rating agencies to challenge and verify the content of the Policy Standards making up GPF.

Appropriate and effectively implemented Policy Standards are a fundamental component of GPF and support attainment and maintenance of an 'upper quartile' control framework as compared against the Group's relevant peer set.

The GPF requires consideration and agreement through Group governance of the level of risk appetite we have and how this is justifiable in the context of our strategic objectives.

There will be ongoing reassessment of risks, risk appetite and controls within the GPF and where appropriate, potential issues will be identified and addressed to ensure the Group moves in line with the set objectives and remains constantly aligned with the 'upper quartile' objective and market practice at all times.

* unaudited

Risk management: Operational risk* continued

Through the three lines of defence model the Group obtains assurance that the standards in the GPF are being adhered to. GPF defines requirements for testing and gathering evidence which demonstrates that each division and function is appropriately controlled.

GPF is owned and managed by the Group's operational risk function and relies upon the operational risk framework for effective implementation and ongoing maintenance.

Three lines of defence model

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational risk, the Group operates a three lines of defence model which outlines principles for the roles, responsibilities and accountabilities for operational risk management.

1st line of defence The business	2nd line of defence Operational risk	3rd line of defence Group Internal Audit
Accountable for the ownership and day-to-day management and control of operational risk. Responsible for implementing processes in compliance with Group policies. Responsible for testing key controls and monitoring compliance with Group policies.	Responsible for the implementation and maintenance of the operational risk framework, tools and methodologies. Responsible for oversight and challenge on the adequacy of the risk and control processes operating in the business.	Responsible for providing independent assurance on the design, adequacy and effectiveness of the Group's system of internal controls.

The Group's Operational Risk Policy Standards (ORPS) are incorporated in the GPF. They provide the direction for delivering effective operational risk management and are designed to enable the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group.

The three lines of defence model and the ORPS apply throughout the Group and are implemented taking into account the nature and scale of the underlying business. The following key operational risk management techniques are included in the ORPS;

- Risk and control assessments: business units identify and assess operational risks to ensure that they are effectively managed, prioritised, documented and aligned to risk appetite;

- Scenario analysis: scenarios for operational risk are used to assess the possible impact of extreme but plausible operational risk loss events. Scenario assessments provide a forward looking basis for managing exposures that are beyond the Group's risk appetite;

-

Loss data management: each business unit's internal loss data management process captures all operational risk loss events above certain minimum thresholds. The data is used to enhance the adequacy and effectiveness of controls, identify opportunities to prevent or reduce the impact of recurrence, identify emerging themes, enable formal loss event reporting and inform risk and control assessments and scenario analysis. Escalation of individual events to senior management is determined by the seriousness of the event. Operational loss events are categorised under the following headings:

- clients, products and business practices;
- technology and infrastructure failures;
- employment practices and workplace safety;
- internal fraud;
- external fraud;
- execution, delivery and process management;
- malicious damage; and
- disaster and public safety.

- New product approval process: this process ensures that all new products or significant variations to existing products are subject to a comprehensive risk assessment. Products are evaluated and approved by specialist areas and are subject to executive approval prior to launch; and

- Self certification process: this requires management to monitor and report regularly on the internal control framework for which they are responsible, confirming its adequacy and effectiveness. This includes certifying compliance with the requirements of Group policies.

Each business unit must manage its operational risk exposure within an acceptable level, testing the adequacy and effectiveness of controls and other risk mitigants (for example, insurance) regularly and documenting the results. Where unacceptable control weaknesses are identified, action plans must be produced and tracked to completion. The Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements. Insurance is used as a risk mitigation tool in controlling the Group's exposures providing protection against financial loss once a risk has crystallised.

* unaudited

Risk management: Operational risk* continued

Operational risk metrics

Reporting forms an integral part of operational risk management. The Group's risk management processes are designed to ensure that issues are identified, escalated and managed on a timely basis. Exposures for each division are reported through monthly risk and control reports, which provide details on the risk exposures and action plans. Events that have a material, actual or potential impact on the Group's finances, reputation or customers, are escalated and reported to divisional and Group executives.

Operational risk events (greater than £10,000) by event category - % of total events by count.
The chart below shows as at 31 December 2010, execution, delivery and process management, together with external fraud, continued to account for circa 90% of losses by count during 2010.

The charts below show a similar distribution of losses by value across the risk categories, captured at the date the event occurred and updated as losses crystallise.

Note:
(1) Work continued throughout 2010 to ensure the treatment, capture and recording of losses in RBS N.V. mirrored the RBS group approach. This has resulted in a small movement in the 2009 metrics recorded in this report compared to those recorded last year.

A high proportion of the Group's operational risk events have a low financial cost associated with them and a very small proportion of operational risk events have a material impact. In 2010, 96% of reported operational losses had a value of £100,000 or less (2009 - 95%), but accounted for 33% of the overall impact (2009 - 18%). In contrast, 0.3% of the operational risk events had a value of £1 million or greater (2009 - 1%), but accounted for 35% of the overall impact (2009 - 61%).

Fraud prevention

Fraud remains a big challenge to the Group, and the rest of the financial services industry. The Group continues to respond to this threat, continually investing in people and processes for both detective and preventative measures, especially in relation to the impact of organised crime against the Group. The Group's key strategic programmes continue to focus on solutions for payment fraud, ATM security, identification of counterfeit documentation and online banking protection for the Group's customers. The Group's investments have resulted in multi-million pound savings and, through close working ties with law enforcement agencies, handing down of significant custodial sentences

* unaudited

Risk management: Operational risk* continued

Physical security

The Group continues to implement strong security measures to ensure the safety of staff, the Group's customers and businesses from physical harm. Against an ever changing threat environment, these measures are kept under constant review and adapted accordingly. The past year has seen protests groups continue to target the Group (most notably Climate Camp in August 2010); robust processes are in place to ensure the safety of customers and staff during these demonstrations. The Group also continues to mitigate against the threat posed by international related terrorism.

Information security

The Group is committed to protecting customer, employee and Group information with regard to the loss of confidentiality, integrity and availability. This extends to all physical and electronic information. All employees and related third parties of the Group are responsible for the protection of Group assets, systems and information. All customer information is treated as confidential and appropriate security is applied to protect the information. Additionally, the Group's information security policy is reviewed regularly and includes processes for managing and monitoring compliance with the policy. The same standards apply to information controlled by the Group or managed by authorised third parties.

The Group continues to invest in programmes to enhance and maintain information security controls and systems. For example, during 2010 the Group have risk assessed the externally facing websites and penetration tested those websites that contain confidential, high-risk Group data and established an assurance team to implement an ongoing programme of third party reviews.

Business continuity

The need to ensure the continuity of business across the Group and the management of crisis situations is a key activity within the risk function. Key risks and threats that the Group is consistently monitoring from a business continuity perspective include pandemics, terrorism, environmental impacts and technology disruptions. Business continuity plans are in place to ensure that the Group can continue key products, services, and operations. A consistent crisis management framework has been developed that includes a six step methodology and allows incidents to be managed and resolved through skilled global teams.

All business continuity plans, related activities and systems are tested annually. The plan data is validated every 6 months and where the impact on business is high, the validation frequency is increased to every 3 months.

Regulatory risk*

Regulatory risk arises from the non-adherence to international and national rules and regulations. The Group manages regulatory risk through a regulatory risk and compliance framework that seeks to ensure the Group is in compliance with all banking, securities, insurance and anti-money laundering regulations defined by more than 120 different regulatory bodies and central banks across the world. This framework comprises global regulatory risk policies, tracking of regulatory developments, training and awareness, assurance and monitoring and regulatory relationship management.

Global regulatory risk policies

Within the Group Policy Framework (GPF), regulatory risk and compliance policies define minimum standards for all businesses to adhere to on a global basis. These policies are primarily driven by the rules and regulations set by the FSA as the Group's lead regulator. These global minimum standards are supplemented by division specific policies where appropriate (product specific or local market specific requirements).

Regulatory developments
Regulatory environments are constantly evolving and it is critical that the Group both understands early on the drivers for this change and be able to assess the potential impact of prospective rules and regulations on the different businesses. The regulatory developments tracker seeks to identify, track and monitor all such material changes and ensure that an appointed senior executive is responsible for assessing the potential impacts on the Group's business. Such activity supports both effective engagement in the regulatory consultation process, and planning for the introduction of new or changed rules and regulations.

During the last 12 months the Group has experienced unprecedented levels of prospective rules and regulations particularly in the area of prudential regulation (capital, liquidity, governance and risk management), and to the treatment of systemically important entities, in particular through initiatives on recovery and resolution plans ('living wills') - see page 344 for regulatory developments and reviews.

Training and awareness
Maintaining compliance with existing rules and regulations requires a continued investment in professional training and maintaining risk awareness. The group undertakes extensive training both with group wide learning initiatives (e.g. anti-money laundering) as well as divisional or product specific training. To support the professional development of the Group's regulatory risk staff the Group has a comprehensive progressive training programme that is deployed on a global basis.

Assurance and monitoring
Assurance and monitoring activities are key to ensuring that the Group can demonstrate ongoing compliance with existing rules and regulations. Such activities are conducted in both the first line and second line of defence. Work to design, implement and embed enhanced monitoring tools was undertaken in 2010 and will continue into 2011.

Regulatory relationship management
The Group is committed to working with its regulators in an open and constructive way as it deals with both the evolution of regulatory frameworks as well as the ongoing compliance to existing rules and regulations. The regulatory relationship management tool is used to track, record, monitor and report on all material regulatory engagement to ensure that activities remain co-ordinated across the Group - see page 343 for a description of the key regulatory and supervisory bodies with which the Group engages.

* unaudited

Risk management continued

Reputation risk*

Reputation risk is defined as the potential loss in reputation that could lead to negative publicity, loss of revenue, costly litigation, a decline in the customer base or the exit of key Group employees.

Reputation risk can arise from actions taken by the Group or a failure to take action, such as failing to assess the environmental, social or ethical impacts of clients or projects that the Group has provided products or services to.

The Group seeks to safeguard its reputation by considering the impact on the value of its franchise from how it conducts business, its choice of customers and the way stakeholders view the Group. Managing the Group’s reputation is the joint responsibility of all employees, and reputational considerations should, as part of standard practice, be integrated into the Group’s day-to-day decision making structures.

Currently the Group manages reputational risk through a number of functions, such as divisions, Group Communications, Group Sustainability and an Environmental, Social and Ethical (ESE) risk management function. The latter function is responsible for assessing ESE risks associated with business engagements and business divisions.

The Board has ultimate responsibility for managing any impact on the reputation of the Group arising from its operations. The Group Sustainability Committee (established at the beginning of 2010) sets the overall strategy and approach for the management of Group sustainability, however all parts of the Group take responsibility for reputation management.

The risk is viewed as material given the central nature of the Group’s market reputation in the strategic risk objectives.

Pension risk*

The Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes’ liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. The Group is exposed to the risk that the market value of the schemes’ assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes.

The RBS Group Pension Fund (“Main scheme”) is the largest of the schemes and the main source of pension risk. The Main scheme operates under a trust deed under which the corporate trustee, RBS Pension Trustees Limited, is a wholly owned subsidiary of The Royal Bank of Scotland plc and the trustee board comprises six directors selected by the Group and four directors nominated by members.

The trustee is solely responsible for the investment of the schemes assets which are held separately from the assets of the Group. The Group and the trustee must agree on the investment principles and the funding plan.

In October 2006, the Main scheme was closed to new employees. In November 2009, the Group confirmed that it was making changes to the Main scheme and a number of other defined benefit schemes including the introduction of a limit of 2% per annum (or Consumer Price Indices (CPI) inflation, if lower) to the amount of any salary increase that will count for pensionable purposes.

Risk appetite and investment policy are agreed by the trustee with quantitative and qualitative input from the scheme actuaries and investment advisers. The trustee also consults with the Group to obtain its view on the appropriate level of risk within the pension fund.

The Group maintains an independent review of risk within its pension funds. The Group Risk Committee now monitors pension obligation risk on an ongoing basis with a monthly report illustrating the funding positions and key sensitivities of the Group's pension schemes. Additionally, as part of the Internal Capital Adequacy Assessment Process (ICAAP) process, the change in asset and liability values is modelled over a twelve-month time horizon under a stressed scenario.

The funding valuation of the Main scheme at 31 March 2010 is currently in progress. Further details are given in Note 4 on the accounts.

The Main scheme, which represents 84% of plan assets at 31 December 2010, is invested in a diversified portfolio of quoted and private equity, government and corporate fixed interest and index-linked bonds, and other assets including property and hedge funds. The trustee has taken measures to partially mitigate inflation and interest rate risks both by investment in suitable physical assets and by entering into inflation and interest rate swaps. The Main scheme has an additional exposure to rewarded risk by investing in equity futures.

The table below shows the impact on the Main schemes assets and liabilities (measured according to IAS 19 'Employee Benefits') of changes in interest rates and equity values at the year end, taking account of the current asset allocation and hedging arrangements.

	Change in value of assets £m	Change in value of liabilities £m	Decrease/ (increase) in net pension obligations £m
As at 31 December 2010			
Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads	422	193	229
Fall in real swap yields of 0.25% at all durations with no change in credit spreads	355	799	(444)
Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields	98	1,005	(907)
Fall in equity values of 10%	(1,083)	—	(1,083)

* unaudited

Risk management continued
Other risk exposures

Risk management: Other risk exposures

All the disclosures in this section (pages 144 to 160) are audited unless otherwise indicated with an asterisk (*).

Explanatory note
These disclosures provide information on certain elements of the Group's credit market activities, the majority of which are in Non-Core and, to a lesser extent, Global Banking & Markets, US Retail & Commercial and Group Treasury. For credit valuation adjustments (CVA), leveraged finance and conduits disclosures, the information presented has been analysed between the Group's Core and Non-Core businesses.

Definitions of acronyms used in this section can be found in the Glossary on pages 390 to 395.

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

	2010	2009		2008	
	Group	Group before RFS MI	Group	Group before RFS MI	Group
	£bn	£bn	£bn	£bn	£bn
Securities issued by central and local governments	124.0	134.1	146.9	95.1	105.8
Asset-backed securities	70.8	87.6	88.1	111.1	111.1
Securities issued by corporates and other entities	9.7	13.4	14.4	24.3	26.2
Securities issued by banks and building societies	13.0	14.0	17.8	22.7	24.4
	217.5	249.1	267.2	253.2	267.5

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

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

The following tables summarise the gross and net exposures and carrying values of these securities by geography of the underlying assets at 31 December 2010, 2009 and 2008. Gross exposures represent the principal amounts relating to ABS. G10 government RMBS comprises securities that are: (a) guaranteed or effectively guaranteed by the US government, by way of its support for US federal agencies and government sponsored enterprises or (b) guaranteed by the Dutch government. Net exposures represent the carrying value after taking account of the hedge protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected. The tables at 31 December 2009 exclude RMBS covered bonds in RFS MI, comprising gross exposure - £558 million, carrying value - £579 million, and net exposure - £579 million.

Risk management: Other risk exposures continued

Asset-backed securities by product, geography and measurement classification

2010	US £m	UK £m	Other Europe £m	RoW (2) £m	Total £m	FVTPL (1) HFT (3) £m	FVTPL (1) DFV (4) £m	AFS (5) £m	LAR (6) £m
Gross exposure									
RMBS: G10 government	24,207	16	6,422	—	30,645	13,840	—	16,805	—
RMBS: covered bond	138	208	8,525	—	8,871	—	—	8,871	—
RMBS: prime	1,784	3,385	1,118	192	6,479	1,605	1	4,749	124
RMBS: non-conforming	1,249	2,107	92	—	3,448	708	—	1,313	1,427
RMBS: sub-prime	792	365	139	221	1,517	819	—	496	202
CMBS	3,086	1,451	912	45	5,494	2,646	120	1,409	1,319
CDOs	12,156	128	453	—	12,737	7,951	—	4,687	99
CLOs	6,038	134	879	9	7,060	1,062	—	5,572	426
Other ABS	3,104	1,144	2,871	1,705	8,824	1,533	—	4,523	2,768
	52,554	8,938	21,411	2,172	85,075	30,164	121	48,425	6,365
Carrying value									
RMBS: G10 government	24,390	16	5,958	—	30,364	13,765	—	16,599	—
RMBS: covered bond	142	208	7,522	—	7,872	—	—	7,872	—
RMBS: prime	1,624	3,000	931	192	5,747	1,384	1	4,249	113
RMBS: non-conforming	1,084	1,959	92	—	3,135	605	—	1,102	1,428
RMBS: sub-prime	638	255	120	205	1,218	681	—	344	193
CMBS	2,936	1,338	638	38	4,950	2,262	118	1,281	1,289
CDOs	3,135	69	254	—	3,458	1,341	—	2,021	96
CLOs	5,334	102	635	3	6,074	691	—	4,958	425
Other ABS	2,780	945	2,615	1,667	8,007	1,259	—	4,089	2,659
	42,063	7,892	18,765	2,105	70,825	21,988	119	42,515	6,203
Net exposure									
RMBS: G10 government	24,390	16	5,958	—	30,364	13,765	—	16,599	—
RMBS: covered bond	142	208	7,522	—	7,872	—	—	7,872	—
RMBS: prime	1,523	2,948	596	192	5,259	897	1	4,248	113
RMBS: non-conforming	1,081	1,959	92	—	3,132	602	—	1,102	1,428
RMBS: sub-prime	289	253	112	176	830	305	—	332	193
CMBS	1,823	1,336	458	38	3,655	1,188	10	1,230	1,227
CDOs	1,085	39	245	—	1,369	743	—	530	96
CLOs	1,387	102	629	1	2,119	673	—	1,021	425
Other ABS	2,293	748	2,609	1,659	7,309	690	—	4,081	2,538
	34,013	7,609	18,221	2,066	61,909	18,863	11	37,015	6,020

For notes to this table refer to page 147.

Risk management: Other risk exposures continued
Asset-backed securities by product, geography and measurement classification continued

						FVTPL (1)			
	US	UK	Other Europe	RoW (2)	Total	HFT (3)	DFV (4)	AFS (5)	LAR (6)
2009	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross exposure									
RMBS: G10 government	26,644	17	7,016	94	33,771	13,536	—	20,235	—
RMBS: covered bond	49	297	9,019	—	9,365	—	—	9,365	—
RMBS: prime	2,965	5,276	4,567	222	13,030	6,274	147	5,761	848
RMBS: non-conforming	1,341	2,138	128	—	3,607	635	—	1,498	1,474
RMBS: sub-prime	1,668	724	195	561	3,148	1,632	17	1,020	479
CMBS	3,422	1,781	1,420	75	6,698	2,936	209	1,842	1,711
CDOs	12,382	329	571	27	13,309	9,080	1	3,923	305
CLOs	9,092	166	2,169	1,173	12,600	5,346	—	6,581	673
Other ABS	3,587	1,980	5,031	1,569	12,167	2,912	18	5,252	3,985
	61,150	12,708	30,116	3,721	107,695	42,351	392	55,477	9,475
Carrying value									
RMBS: G10 government	26,984	17	6,870	33	33,904	13,397	—	20,507	—
RMBS: covered bond	50	288	8,734	—	9,072	—	—	9,072	—
RMBS: prime	2,696	4,583	4,009	212	11,500	5,133	141	5,643	583
RMBS: non-conforming	958	1,957	128	—	3,043	389	—	1,180	1,474
RMBS: sub-prime	977	314	146	387	1,824	779	17	704	324
CMBS	3,237	1,305	924	43	5,509	2,279	216	1,637	1,377
CDOs	3,275	166	400	27	3,868	2,064	1	1,600	203
CLOs	6,736	112	1,469	999	9,316	3,296	—	5,500	520
Other ABS	2,886	1,124	4,369	1,187	9,566	1,483	19	4,621	3,443
	47,799	9,866	27,049	2,888	87,602	28,820	394	50,464	7,924
Net exposure									
RMBS: G10 government	26,984	17	6,870	33	33,904	13,397	—	20,507	—
RMBS: covered bond	50	288	8,734	—	9,072	—	—	9,072	—
RMBS: prime	2,436	3,747	3,018	172	9,373	3,167	142	5,480	584
RMBS: non-conforming	948	1,957	128	—	3,033	379	—	1,180	1,474
RMBS: sub-prime	565	305	137	290	1,297	529	17	427	324
CMBS	2,245	1,228	595	399	4,467	1,331	203	1,556	1,377
CDOs	743	124	382	26	1,275	521	1	550	203
CLOs	1,636	86	1,104	39	2,865	673	—	1,672	520
Other ABS	2,117	839	4,331	1,145	8,432	483	19	4,621	3,309
	37,724	8,591	25,299	2,104	73,718	20,480	382	45,065	7,791

For notes to this table refer to page 147.

Risk management: Other risk exposures continued

Asset-backed securities by product, geography and measurement classification continued

						FVTPL (1)			
	US	UK	Other Europe	RoW (2)	Total	HFT (3)	DFV (4)	AFS (5)	LAR (6)
2008	£m	£m	£m	£m	£m	£m	£m	£m	£m
Carrying value									
RMBS: G10 government	33,464	25	7,642	46	41,177	18,631	—	22,546	—
RMBS: covered bond	44	296	10,040	—	10,380	—	—	10,380	—
RMBS: prime	5,623	4,754	6,154	246	16,777	7,272	166	8,769	570
RMBS: non-conforming	1,111	2,906	—	—	4,017	352	—	2,183	1,482
RMBS: sub-prime	1,824	445	439	381	3,089	1,594	16	913	566
CMBS	2,145	1,395	1,646	141	5,327	2,751	13	1,126	1,437
CDOs	8,275	259	441	45	9,020	4,389	—	4,280	351
CLOs	6,428	329	2,605	255	9,617	3,385	—	5,299	933
Other ABS	3,582	1,622	5,098	1,437	11,739	1,505	41	6,571	3,622
	62,496	12,031	34,065	2,551	111,143	39,879	236	62,067	8,961
Net exposure									
RMBS: G10 government	33,464	25	7,642	46	41,177	18,631	—	22,546	—
RMBS: covered bond	44	296	10,040	—	10,380	—	—	10,380	—
RMBS: prime	5,548	3,667	5,212	215	14,642	5,138	166	8,768	570
RMBS: non-conforming	1,106	2,906	—	—	4,012	346	—	2,184	1,482
RMBS: sub-prime	358	408	380	313	1,459	346	16	571	526
CMBS	1,147	1,225	1,095	79	3,546	1,178	13	918	1,437
CDOs	2,402	127	311	—	2,840	1,618	—	873	349
CLOs	874	259	2,139	171	3,443	845	—	1,665	933
Other ABS	3,507	1,367	4,299	1,256	10,429	196	40	6,572	3,621
	48,450	10,280	31,118	2,080	91,928	28,298	235	54,477	8,918

Notes:

(1) Fair value through profit or loss.

(2) Rest of the world.

(3) Held-for-trading.

(4) Designated as at fair value.

(5) Available-for-sale.

(6) Loans and receivables.

Risk management: Other risk exposures continued

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

2010	AAA £m	AA to AA+ £m	A to AA- £m	BBB- to A- £m	Non-investment grade £m	Unrated £m	Total £m
RMBS: G10 government	28,835	1,529	—	—	—	—	30,364
RMBS: covered bond	7,107	357	408	—	—	—	7,872
RMBS: prime	4,355	147	67	82	900	196	5,747
RMBS: non-conforming	1,754	144	60	316	809	52	3,135
RMBS: sub-prime	317	116	212	39	458	76	1,218
CMBS	2,789	392	973	500	296	—	4,950
CDOs	444	567	296	203	1,863	85	3,458
CLOs	2,490	1,786	343	527	332	596	6,074
Other ABS	3,144	1,297	885	1,718	265	698	8,007
	51,235	6,335	3,244	3,385	4,923	1,703	70,825
2009							
RMBS: G10 government	33,779	125	—	—	—	—	33,904
RMBS: covered bond	8,645	360	67	—	—	—	9,072
RMBS: prime	9,211	676	507	547	558	1	11,500
RMBS: non-conforming	1,981	197	109	160	594	2	3,043
RMBS: sub-prime	578	121	306	87	579	153	1,824
CMBS	3,441	599	1,022	298	147	2	5,509
CDOs	615	944	254	944	849	262	3,868
CLOs	2,718	4,365	607	260	636	730	9,316
Other ABS	4,099	1,555	1,014	1,947	152	799	9,566
	65,067	8,942	3,886	4,243	3,515	1,949	87,602
2008							
RMBS: G10 government	41,168			—	—	9	41,177
RMBS: covered bond	10,380			—	—	—	10,380
RMBS: prime	15,252			1,417	106	2	16,777
RMBS: non-conforming	3,532			337	146	2	4,017
RMBS: sub-prime	1,362			936	790	1	3,089
CMBS	3,702			1,586	38	1	5,327
CDOs	4,510			2,041	2,088	381	9,020
CLOs	7,299			1,601	268	449	9,617
Other ABS	6,649			3,519	242	1,329	11,739
	93,854	—	—	11,437	3,678	2,174	111,143

Key points

- Carrying values of asset-backed securities decreased by £16.8 billion during 2010 with net reductions across all portfolios.

- Within G10 government RMBS, net sell-downs by the US Mortgage Trading business in GBM in the first quarter of 2010, as part of the Group's repositioning in light of the US government's purchase of US assets was off-set by purchases in the second half of the year, with the latter reflecting the perceived investor appetite. The decrease in the US AFS portfolio reflected balance sheet restructuring in US Retail & Commercial during the third quarter of 2010.

- Α ≤5.8 βιλλιον ρεδυχτιον ωασ σεεν ιν πριμε ΡΜΒΣ πριμαριλψ ιν ΓΒΜ ανδ Γρουπ Τρεασυρψ, αχροσσ Ευροπεαν (≤4.7 βιλλιον) ανδ ΥΣ (≤1.1 βιλλιον) πορτφολιοσ ρεφλεχτινγ ρεσπεχτιϖελψ βαλανχε σηεετ μαναγεμεντ ανδ ρεποσιτιονινγ ιν λιγητ οφ ινχρεασεδ λιθυιδιτψ ιν τηε ΥΣ ΡΜΒΣ μαρκετ.

- CDO and CLO portfolios declined by £3.7 billion reflecting asset reductions in Non-Core; however, some CDO exposures were downgraded during the year resulting in increased non-investment grade positions.

Risk management: Other risk exposures continued

Non-investment grade and unrated ABS

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

	Non-investment grade				Unrated			
	HFT	AFS	LAR	Total	HFT	AFS	LAR	Total
2010	£m	£m	£m	£m	£m	£m	£m	£m
RMBS: prime	354	535	11	900	196	—	—	196
RMBS: non-conforming	389	414	6	809	52	—	—	52
RMBS: sub-prime	437	21	—	458	76	—	—	76
CMBS	198	17	81	296	—	—	—	—
CDOs	691	1,151	21	1,863	85	—	—	85
CLOs	239	5	88	332	267	329	—	596
Other ABS	148	17	100	265	191	162	345	698
	2,456	2,160	307	4,923	867	491	345	1,703
2009								
RMBS: prime	120	430	8	558	—	1	—	1
RMBS: non-conforming	253	341	—	594	—	2	—	2
RMBS: sub-prime	339	240	—	579	153	—	—	153
CMBS	89	3	55	147	1	—	1	2
CDOs	487	300	62	849	143	119	—	262
CLOs	269	359	8	636	207	523	—	730
Other ABS	78	63	11	152	270	134	395	799
	1,635	1,736	144	3,515	774	779	396	1,949
2008								
RMBS: G10 government	—	—	—	—	9	—	—	9
RMBS: prime	59	47	—	106	2	—	—	2
RMBS: non-conforming	69	74	3	146	1	1	—	2
RMBS: sub-prime	636	124	30	790	1	—	—	1
CMBS	38	—	—	38	—	—	1	1
CDOs	1,219	869	—	2,088	173	142	66	381
CLOs	80	188	—	268	165	279	5	449
Other ABS	122	49	71	242	115	404	810	1,329
	2,223	1,351	104	3,678	466	826	882	2,174

Key point

- Non-investment grade securities increased by £1.4 billion of which £1.0 billion was in CDOs reflecting purchases by GBM's Mortgage Trading business as well as credit down grades and rating withdrawals of certain ABS structures in Non-Core during the year.

Risk management: Other risk exposures continued

Residential mortgage-backed securities

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

The main categories of mortgages that serve as collateral to RMBS held by the Group with related vintages are set out below and described in the Glossary on pages 390 to 395. The US market has more established definitions of differing underlying mortgage quality and these are used as the basis for the Group's RMBS categorisation.

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

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

	By geography					By classification				
	US	UK	Other Europe	RoW	Total	G10 government	Covered bond	Prime	Non-conforming	Sub-prime
2010	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2004 and earlier	4,405	175	1,057	50	5,687	4,148	641	678	90	130
2005	2,579	176	3,435	28	6,218	2,379	2,410	634	567	228
2006	1,082	2,249	5,460	121	8,912	2,106	3,451	2,129	736	490
2007	2,576	2,370	4,135	33	9,114	4,774	1,352	1,280	1,477	231
2008	2,314	58	420	155	2,947	2,598	18	223	104	4
2009 and later	14,922	410	116	10	15,458	14,359	–	803	161	135
	27,878	5,438	14,623	397	48,336	30,364	7,872	5,747	3,135	1,218
2009										
2004 and earlier	8,504	293	1,760	33	10,590	7,951	752	1,460	99	328
2005	4,221	783	4,252	74	9,330	3,801	2,582	2,173	510	264
2006	1,847	3,116	7,449	216	12,628	2,691	4,135	4,514	690	598
2007	1,844	2,957	5,916	60	10,777	4,394	1,585	2,842	1,529	427
2008 and later	15,249	10	510	249	16,018	15,067	18	511	215	207

	31,665	7,159	19,887	632	59,343	33,904	9,072	11,500	3,043	1,824
2008										
2004 and earlier	6,839	887	2,122	102	9,950	5,959	702	2,507	122	660
2005	9,666	1,694	5,265	65	16,690	7,179	2,993	4,794	1,371	353
2006	3,136	3,273	9,139	234	15,782	3,803	4,471	5,376	872	1,260
2007 and later	22,425	2,572	7,749	272	33,018	24,236	2,214	4,100	1,652	816
	42,066	8,426	24,275	673	75,440	41,177	10,380	16,777	4,017	3,089

Risk management: Other risk exposures continued

Credit valuation adjustments (CVA)

CVA represents an estimate of the adjustment to arrive at fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.

The table below details the Group's CVA by type of counterparty.

	2010	2009	2008
	£m	£m	£m
Monoline insurers	2,443	3,796	5,988
CDPCs	490	499	1,311
Other counterparties	1,714	1,588	1,738
	4,647	5,883	9,037

Monoline insurers

The Group has purchased protection from monoline insurers ("monolines"), mainly against specific ABS. Monolines specialise in providing credit protection against the principal and interest cash flows due to the holders of debt instruments in the event of default by the debt instrument counterparty. This protection is typically held in the form of derivatives such as credit default swaps (CDSs) referencing underlying exposures held directly or synthetically by the Group.

The gross mark-to-market of the monoline protection depends on the value of the instruments against which protection has been bought. A positive fair value, or a valuation gain, in the protection is recognised if the fair value of the instrument it references decreases. For the majority of trades the gross mark-to-market of the monoline protection is determined directly from the fair value price of the underlying reference instrument, however for the remainder of the trades, the gross mark-to-market is determined using industry standard models.

The methodology employed to calculate the monoline CVA uses market implied probability of defaults and internally assessed recovery levels to determine the level of expected loss on monoline exposures of different maturities. The probability of default is calculated with reference to market observable credit spreads and recovery levels. CVA is calculated at a trade level by applying the expected loss, corresponding to each trade's expected maturity, to the gross mark-to-market of the monoline protection. The expected maturity of each trade reflects the scheduled notional amortisation of the underlying reference instruments and whether payments due from the monoline are received at the point of default or over the life of the underlying reference instruments.

The table below summarises the Group's exposure to monolines, all of which are in Non-Core.

	2010	2009	2008
	£m	£m	£m
Gross exposure to monolines	4,023	6,170	11,581
Hedges with financial institutions	(71)	(531)	(789)
Credit valuation adjustment	(2,443)	(3,796)	(5,988)
Net exposure to monolines	1,509	1,843	4,804
Credit valuation adjustment as a % of gross exposure	61%	62%	52%
Counterparty and credit risk RWAs*	£17.8bn	£13.7bn	£7.3bn

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

	2010	2009	2008
	£m	£m	£m
Credit valuation adjustment at 1 January	(3,796)	(5,988)	(862)
Credit valuation adjustment at 31 December	(2,443)	(3,796)	(5,988)
Decrease/(increase) in credit valuation adjustment	1,353	2,192	(5,126)
Net debit relating to realisations, hedges, foreign exchange and other movements	(844)	(3,290)	(347)
Net (debit)/credit relating to reclassified debt securities	(305)	(1,468)	1,916
Net credit/(debit) to income statement (1)	204	(2,566)	(3,557)

Note:

(1) Comprises the following elements for the year ended 2010 and 2009:
- a loss of £5 million (2009 - £2,387 million) in income from trading activities;
- impairment reversals/(losses) of £71 million (2009 - (£239) million); and
- other income of £138 million (2009 - £60 million) relating to reclassified debt securities.

* unaudited

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Risk management: Other risk exposures continued
Monoline insurers continued
A number of debt instruments with monoline protection were reclassified from HFT to AFS in 2008. Changes in the fair value since the reclassification are recognised in the income statement to the extent that they are considered to be impaired. Changes in the fair value of the related monoline CDSs continue to be recorded in the income statement.

The fair value of these reclassified debt securities at 31 December 2010 was £5,572 million (1 July 2008 - £6,293 million after adjusting for both principal based cash flows and foreign exchange effects between 1 July 2008 and 31 December 2010). As a result of these reclassifications, total cumulative losses of £331 million have not been recognised in the income statement.

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

2010	Notional: protected assets £m	Fair value: reference protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Hedges £m	Net exposure £m
A to AA-	6,336	5,503	833	272	—	561
Non-investment grade	8,555	5,365	3,190	2,171	71	948
	14,891	10,868	4,023	2,443	71	1,509
Of which:						
CMBS	4,149	2,424	1,725	1,253		
CDOs	1,133	256	877	593		
CLOs	6,724	6,121	603	210		
Other ABS	2,393	1,779	614	294		
Other	492	288	204	93		
	14,891	10,868	4,023	2,443		
2009						
A to AA-	7,143	5,875	1,268	378	—	890
Non-investment grade	12,598	7,696	4,902	3,418	531	953
	19,741	13,571	6,170	3,796	531	1,843
Of which:						
CMBS	4,253	2,034	2,219	1,562		
CDOs	2,284	797	1,487	1,059		
CLOs	10,007	8,584	1,423	641		
Other ABS	2,688	1,861	827	412		
Other	509	295	214	122		
	19,741	13,571	6,170	3,796		
2008						
A to AA+	8,937	6,537	2,400	1,067	—	1,333
BBB- to A-	16,895	8,396	8,499	4,426	768	3,305

Non-investment grade	2,188	1,506	682	495	21	166
	28,020	16,439	11,581	5,988	789	4,804
Of which:						
CMBS	4,849	2,388	2,461	1,429		
CDOs	5,779	1,395	4,384	2,201		
CLOs	12,865	9,673	3,192	1,556		
Other ABS	3,759	2,525	1,234	627		
Other	768	458	310	175		
	28,020	16,439	11,581	5,988		

Risk management: Other risk exposures continued
Monoline insurers continued

Key points
- Exposure to monolines decreased over the period due to a combination of restructuring certain exposures and higher prices of underlying reference instruments, partially offset by the strengthening of the US dollar against sterling.

- The CVA decreased on a total basis, reflecting the reduction in exposure, but was stable on a relative basis with the impact of tighter credit spreads offset by an increase in the expected lives of certain trades.

- The reduction in the Group's RWA requirements over the quarter was driven by the reduction in exposure to monolines and the impact of restructuring certain risk structures.

- During the year there was a significant increase in the RWA requirements of RBS N.V. following its migration to the Basel II regime. Regulatory intervention at certain monoline counterparties triggered International Swaps and Derivative Association (ISDA) credit events in the period. At the point of trigger the exposure to these counterparties was excluded from the RWA calculations and capital deductions of £171 million were taken instead. The impact of this together with restructuring certain exposures and an improvement in the rating of underlying reference bonds held by the Group to investment grade status were the main drivers of the reduction in RWA requirements during the second half of the year. *

The Group also has indirect exposures to monoline insurers through wrapped securities and other assets with credit enhancement from monoline insurers. These securities are traded with the benefit of this credit enhancement. Any deterioration in the credit rating of the monoline is reflected in the fair value of these assets.

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

The Group has purchased credit protection from CDPCs through tranched and single name credit derivatives. The Group's exposure to CDPCs is predominantly due to tranched credit derivatives ("tranches"). A tranche references a portfolio of loans and bonds and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point).

The Group has predominantly traded senior tranches with CDPCs, the average attachment and detachment points are 13% and 49% respectively (2009 - 15% and 51% respectively; 2008 - 16% and 50% respectively), and the majority of the loans and bonds in the reference portfolios are investment grade.

The gross mark-to-market of the CDPC protection is determined using industry standard models. The methodology employed to calculate the CDPC CVA is different to that outlined above for monolines, as there are no market observable credit spreads and recovery levels for these entities. The level of expected loss on CDPC exposures is estimated with reference to recent market events impacting CDPCs, including communication activity, and by analysing the underlying trades and the cost of hedging expected default losses in excess of the capital in each vehicle.

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

	2010 £m	2009 £m	2008 £m
Gross exposure to CDPCs	1,244	1,275	4,776
Credit valuation adjustment	(490)	(499)	(1,311)
Net exposure to CDPCs	754	776	3,465
Credit valuation adjustment as a % of gross exposure	39%	39%	27%
Counterparty and credit risk RWAs*	£7.2bn	£7.5bn	£5.0bn
Capital deductions*	£280m	£347m	—

* unaudited

Risk management: Other risk exposures continued
Credit derivative product companies continued

The table below details CDPC exposures by rating.

2010	Notional: protected assets £m	Fair value: reference protected assets £m	Gross exposure £m	Credit valuation adjustment £m	Net exposure £m
AAA	213	212	1	—	1
A to AA-	644	629	15	4	11
Non-investment grade	20,066	19,050	1,016	401	615
Unrated	4,165	3,953	212	85	127
	25,088	23,844	1,244	490	754
2009					
AAA	1,658	1,637	21	5	16
BBB- to A-	1,070	1,043	27	9	18
Non-investment grade	17,696	16,742	954	377	577
Unrated	3,926	3,653	273	108	165
	24,350	23,075	1,275	499	776
2008					
AAA	6,351	4,780	1,571	314	1,257
AA to AA+	1,195	1,116	79	16	63
A to AA-	13,092	10,891	2,201	657	1,544
BBB- to A-	4,601	3,676	925	324	601
	25,239	20,463	4,776	1,311	3,465

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

	2010 £m	2009 £m	2008 £m
Credit valuation adjustment at 1 January	(499)	(1,311)	(44)
Credit valuation adjustment at 31 December	(490)	(499)	(1,311)
Decrease/(increase) in credit valuation adjustment	9	812	(1,267)
Net (debit)/credit relating to realisations, hedges, foreign exchange and other movements	(150)	(1,769)	652
Income from trading activities - net losses	(141)	(957)	(615)

Key points

- Losses reduced significantly in 2010 due to smaller exposures and reduced losses on hedges that were introduced to cap the exposures.

- The CVA decrease for the year reflected exposure reductions, due to trade commutations, tighter credit spreads of the underlying reference portfolios, partially offset by an increase in the relative value of senior tranches compared with the underlying reference portfolios and foreign currency movements.

- Counterparty and credit RWAs and capital deductions decreased in line with the exposure.

- Certain CDPCs, where the Group has hedges in place to cap the exposure, are excluded from the RWA calculations with capital deduction taken instead.

Other counterparties
The CVA for all other counterparties is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Expected losses are determined from the market implied probability of defaults and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the average credit spreads and recovery levels of baskets of similarly rated entities. A weighting of 50% to 100% is applied to arrive at the CVA. The weighting reflects portfolio churn and varies according to the counterparty credit quality.

Risk management: Other risk exposures continued
Credit derivative product companies continued
Expected losses are applied to estimated potential future exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors. Potential future exposures arising from vanilla products (including interest rate and foreign exchange derivatives) are modelled jointly using the Group's core counterparty risk systems. The majority of the Group's CVA held in relation to other counterparties arises on these vanilla products. The exposures arising from all other product types are modelled and assessed individually. The potential future exposure to each counterparty is the aggregate of the exposures arising on the underlying product types.

The correlation between exposure and counterparty risk is also incorporated within the CVA calculation where this risk is considered significant. The risk primarily arises on trades with emerging market counterparties where the gross mark-to-market value of the trade, and
therefore the counterparty exposure, increases as the strength of the local currency declines.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

CVA is held against exposures to all counterparties with the exception of the CDS protection that the Group has purchased from HM Treasury, as part of its participation in the Asset Protection Scheme, due to the unique features of this derivative.

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

	2010 £m	2009 £m
Credit valuation adjustment at 1 January	(1,588)	(1,738)
Credit valuation adjustment at 31 December	(1,714)	(1,588)
(Increase)/decrease in credit valuation adjustment	(126)	150
Net debit relating to realisations, hedges, foreign exchange and other movements	(19)	(841)
Income from trading activities - net losses	(145)	(691)

Key points

- The increase in CVA held against exposures to other counterparties was driven by rating downgrades of certain counterparties and the net impact of changes in credit spreads and counterparty exposures due to market moves. This increase was partially offset by a decrease due to the disposal of parts of the RBS Sempra Commodities JV business during the year.

- Losses on hedges and realised defaults are the primary driver of the loss arising on foreign exchange, hedges, realisations and other movements.

Risk management: Other risk exposures continued

Leveraged finance

Leveraged finance is commonly employed to facilitate corporate finance transactions, such as acquisitions or buy-outs, and is so called due to the high ratio of debt to equity (leverage) common in such transactions. A bank acting as a lead manager for a leveraged finance transaction will typically underwrite a loan, alone or with others, and then syndicate the loan to other participants. The Group typically held a portion of these loans as part of its long-term portfolio once primary syndication is completed. Most of the leveraged finance loans held as part of the syndicated lending portfolio were reclassified from HFT to LAR in 2008.

The gross exposure represents the total amount of leveraged finance committed by the Group. The net exposure represents the balance sheet carrying values of drawn leveraged finance and the total undrawn amount. The difference between gross and net exposures is principally due to the cumulative effect of impairment provisions and historic write-downs on assets prior to reclassification.

The table below shows the Groups global markets sponsor-led leveraged finance exposures, all of which are in Non-Core, by industry and geography.

	2010					2009					
			Other					Other			2008
	UK	Americas	Europe	RoW	Total	UK	Americas	Europe	RoW	Total	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross exposure:											
TMT (1)	1,451	689	686	473	3,299	1,656	1,781	1,081	605	5,123	6,527
Industrial	1,009	273	1,144	285	2,711	1,523	1,584	1,781	207	5,095	5,410
Retail	290	8	867	61	1,226	476	17	1,354	71	1,918	3,082
Other	1,074	188	627	182	2,071	1,527	244	1,168	191	3,130	3,286
	3,824	1,158	3,324	1,001	9,307	5,182	3,626	5,384	1,074	15,266	18,305
Net exposure:											
TMT (1)	1,267	656	633	338	2,894	1,532	1,502	1,045	590	4,669	6,148
Industrial	911	181	1,094	277	2,463	973	524	1,594	205	3,296	3,708
Retail	277	8	817	57	1,159	445	17	1,282	68	1,812	2,714
Other	1,014	188	622	182	2,006	1,461	244	1,147	191	3,043	3,199
	3,469	1,033	3,166	854	8,522	4,411	2,287	5,068	1,054	12,820	15,769
Of which:											
Drawn	2,952	673	2,433	694	6,752	3,737	1,944	3,909	950	10,540	12,619
Undrawn	517	360	733	160	1,770	674	343	1,159	104	2,280	3,150
	3,469	1,033	3,166	854	8,522	4,411	2,287	5,068	1,054	12,820	15,769

Notes:

(1) Telecommunications, media and technology.

(2) All of the above exposures are classified as LAR, except £154 million (2009 - £143 million; 2008 - £102 million) which are classified as HFT.

The table below shows the Group’s movement in leveraged finance exposures during the year.

	2010			2009		
	Drawn	Undrawn	Total	Drawn	Undrawn	Total
	£m	£m	£m	£m	£m	£m
Balance at 1 January	10,540	2,280	12,820	12,619	3,150	15,769
Transfers (out)/in (from credit trading business)	(38)	12	(26)	563	41	604
Sales and restructurings	(3,575)	(273)	(3,848)	(247)	(144)	(391)
Repayments and facility reductions	(488)	(272)	(760)	(934)	(392)	(1,326)
Funded deals	(11)	11	—	166	(166)	—
Lapsed/collapsed deals	—	—	—	—	(19)	(19)
Changes in fair value	73	—	73	(31)	—	(31)
Accretion of interest	50	—	50	100	—	100
Net recoveries/(impairment provisions)	131	—	131	(1,041)	—	(1,041)
Exchange and other movements	70	12	82	(655)	(190)	(845)
Balance at 31 December	6,752	1,770	8,522	10,540	2,280	12,820

Key points

- Reduction in exposures reflect the Non-Core strategy.
- Approximately 92% of the above exposures represent senior lending at 31 December 2010.

Risk management: Other risk exposures continued

Leveraged finance continued

In addition to the above, UK Corporate and Ulster Bank have leveraged finance exposures as set out below.

	2010	2009	2008
	£m	£m	£m
UK Corporate			
- debt financing (1)	3,664	4,041	4,496
- senior debt transactions (2)	2,604	3,034	2,330
Total UK Corporate	6,268	7,075	6,826
Ulster Bank	597	621	694
	6,865	7,696	7,520

Notes:
(1) Loans for UK mid-market buyouts, supplementing equity capital provided by third party private equity investors.
(2) Loans to UK mid-corporates supporting acquisitions, recapitalisations or general corporate purposes where higher leverage criteria were met.

Special purpose entities

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

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

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

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

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

The Group sponsors own-asset securitisations primarily as a way of diversifying funding sources. The Group purchases the securities issued in own asset securitisations. During 2008, the Group was able to pledge AAA rated asset-backed securities as collateral for repurchase agreements with major central banks under schemes such as the Bank of England's Special Liquidity Scheme, launched in April 2008, which allowed banks to temporarily swap high-quality mortgage-backed and other securities for liquid UK treasury bills. This practice contributed to the Group's sources of funding in the face of the contraction in the UK market for inter-bank lending, particularly during 2008 and 2009, and investor base for securitisations.

The table below sets out the asset categories, together with the carrying value of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (discussed below), where the assets continue to be recorded on the Group's balance sheet

	2010		2009		2008	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Residential mortgages	76,212	18,215	69,927	15,937	55,714	20,075
Credit card receivables	3,993	34	2,975	1,592	3,004	3,197
Other loans	30,988	974	36,448	1,010	1,679	1,071
Finance lease receivables	510	510	597	597	1,077	857

Assets are significantly greater than liabilities, as all notes issued by funding related own asset securitisation SPEs are purchased by Group companies.

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Risk management: Other risk exposures continued

Conduits

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

Group-sponsored conduits can be divided into multi-seller conduits and own-asset conduits. The Group consolidates both types of conduit where the substance of the relationship between the Group and the conduit vehicle is such that the vehicle is controlled by the Group. Liquidity commitments from the Group to the conduit exceed the nominal amount of assets funded by the conduit as liquidity commitments are sized to cover the funding cost of the related assets.

During the year both multi-seller and own asset conduit assets have been reduced in line with wider Group balance sheet management. The total assets held by Group-sponsored conduits were £20.0 billion at 31 December 2010 (31 December 2009 - £27.4 billion; 31 December 2008 - £49.9 billion).

	2010			2009			
	Core	Non-Core	Total	Core	Non-Core	Total	2008
	£m	£m	£m	£m	£m	£m	£m
Total assets held by the conduits	16,390	3,624	20,014	23,409	3,957	27,366	49,857
Commercial paper issued (1)	15,522	2,540	18,062	22,644	2,939	25,583	48,684
Liquidity and credit enhancements							
Deal specific liquidity							
- drawn	868	1,109	1,977	738	1,059	1,797	1,172
- undrawn	21,935	2,980	24,915	28,628	3,852	32,480	57,929
PWCE (2)	1,025	257	1,282	1,167	341	1,508	2,391
	23,828	4,346	28,174	30,533	5,252	35,785	61,492
Maximum exposure to loss (3)	22,803	4,089	26,892	29,365	4,911	34,276	59,101

Notes:

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

(2) Programme-wide credit enhancement.

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

Information relating to assets in the conduits is set out on pages 159 and 160.

Multi-seller conduits accounted for 44% of the total liquidity and credit enhancements committed by the Group at 31 December 2010 (2009 - 43%; 2008 - 69%). The Group’s multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance. There have been no significant systemic failures within the financial markets similar to that experienced in the second half of 2008 following Lehman Brothers bankruptcy filing in September 2008. The improvement in market conditions has allowed these conduits to move to normal ABCP funding conditions and reduced the need for backstop funding from the Group.

Key points

- Total assets decreased during the year by £7.4 billion in line with the Group's strategy of reducing conduit exposure.

- The average maturity of ABCP issued by the Group's conduits has risen throughout 2010, to 69.4 days (2009 - 58.4 days; 2008 - 72.1 days).

- The maturity of the commercial paper issued by the Group's conduits to mitigate the short-term contingent liquidity risk of providing back-up facilities. The Group's limits sanctioned for such liquidity facilities in 2010 totalled approximately £22.6 billion for multi-seller conduits (2009 - £25.0 billion; 2008 - £42.9 billion). For a very small number of transactions within one multi-seller conduit the liquidity facilities have been provided by third-party banks. This typically occurs on transactions where the third-party bank does not use, or have, its own conduit vehicles.

- The Group's maximum exposure to loss on its multi-seller conduits is £22.8 billion (2009 - £25.2 billion; 2008 - £43.2 billion), being the total amount of the Group's liquidity commitments plus the extent of PWCE of conduit assets for which liquidity facilities were not provided by third parties.

- The Group holds two own-asset conduits, which have assets that were previously funded by the Group. The Group's maximum exposure to loss on these two conduits was £4.1 billion in 2010 (2009 - £9.1 billion; 2008 - £15.9 billion), with £2.2 billion of ABCP outstanding at that date (2009 - £7.7 billion; 2008 - £14.8 billion).

- Additionally the Group established an own-asset conduit in 2009 with a committed liquidity of £26.0 billion (2009 - £25.1 billion) to access the Bank of England's open market operations for contingent funding purposes.

The Group also extends liquidity commitments to multi-seller conduits sponsored by other banks, but typically does not consolidate these entities as the Group does not retain the majority of risks and rewards. The Group's exposure from third-party conduits was £136 million (2009 - £587 million; 2008 - £3.9 billion) representing deal specific liquidity.

Risk management: Other risk exposures continued
Conduits continued

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

	Funded assets				Liquidity for third	Total
	Loans	Securities	Total	Undrawn	parties	exposure
2010	£m	£m	£m	£m	£m	£m
Auto loans	4,943	346	5,289	2,964	—	8,253
Corporate loans	115	2,340	2,455	106	—	2,561
Credit card receivables	2,088	—	2,088	1,209	—	3,297
Trade receivables	761	—	761	1,090	—	1,851
Student loans	757	—	757	532	(132)	1,157
Consumer loans	1,889	—	1,889	111	—	2,000
Mortgages						
- prime	2,569	3	2,572	752	—	3,324
- non-conforming	1,371	—	1,371	20	—	1,391
- sub-prime residential mortgages	103	—	103	19	—	122
- commercial	210	450	660	76	(21)	715
Other	1,072	997	2,069	(8)	(10)	2,051
	15,878	4,136	20,014	6,871	(163)	26,722
2009						
Auto loans	4,293	356	4,649	2,526	—	7,175
Corporate loans	106	7,695	7,801	161	—	7,962
Credit card receivables	4,083	—	4,083	1,058	—	5,141
Trade receivables	806	—	806	1,351	—	2,157
Student loans	915	—	915	263	(132)	1,046
Consumer loans	1,686	—	1,686	222	—	1,908
Mortgages						
- prime	2,739	3	2,742	750	—	3,492
- non-conforming	1,548	—	1,548	193	—	1,741
- commercial	413	458	871	155	(22)	1,004
Other	872	1,393	2,265	232	(12)	2,485
	17,461	9,905	27,366	6,911	(166)	34,111
2008						
Auto loans	9,924	383	10,307	1,871	—	12,178
Corporate loans	430	11,042	11,472	534	—	12,006
Credit card receivables	5,844	—	5,844	922	—	6,766
Trade receivables	2,745	—	2,745	1,432	(71)	4,106
Student loans	2,555	—	2,555	478	(132)	2,901
Consumer loans	2,371	—	2,371	409	—	2,780
Mortgages						

- prime	4,416	2,250	6,666	1,188	—	7,854
- non-conforming	2,181	—	2,181	727	—	2,908
- commercial	1,228	507	1,735	66	(23)	1,778
Other	1,851	2,130	3,981	1,615	—	5,596
	33,545	16,312	49,857	9,242	(226)	58,873

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Risk management: Other risk exposures continued
Conduits continued

	CP funded assets										
	Geographic distribution						Credit ratings (S&P equivalent)				
	UK	Other Europe	US	RoW	Total	Weighted average life -	AAA	AA	A	BBB	Below BBB
2010	£m	£m	£m	£m	£m	years	£m	£m	£m	£m	£m
Auto loans	429	962	3,434	464	5,289	1.6	4,827	354	101	7	—
Corporate loans	22	1,513	709	211	2,455	0.8	2,166	161	128	—	—
Credit card receivables	144	—	1,944	—	2,088	1.4	1,912	125	—	51	—
Trade receivables	—	261	500	—	761	1.1	265	353	95	48	—
Student loans	116	—	641	—	757	1.9	641	116	—	—	—
Consumer loans	766	462	661	—	1,889	2.5	16	—	1,873	—	—
Mortgages											—
- prime	161	—	—	2,411	2,572	2.7	1,043	1,476	32	21	—
- non-conforming	712	659	—	—	1,371	4.8	782	273	316	—	—
- sub-prime	103	—	—	—	103	2.3	—	68	—	35	—
- commercial	627	—	—	33	660	11.8	16	5	635	4	—
Other	447	455	353	814	2,069	1.7	95	52	1,242	680	—
	3,527	4,312	8,242	3,933	20,014	2.3	11,763	2,983	4,422	846	—
2009											
Auto loans	476	982	2,621	570	4,649	1.8	2,965	1,547	137	—	—
Corporate loans	312	5,213	1,411	865	7,801	1.0	7,584	111	106	—	—
Credit card receivables	177	—	3,823	83	4,083	0.8	2,781	759	420	123	—
Trade receivables	—	334	438	34	806	0.7	446	266	60	34	—
Student loans	117	—	798	—	915	0.7	798	117	—	—	—
Consumer loans	733	800	153	—	1,686	1.5	68	50	1,553	15	—
Mortgages											
- prime	138	—	—	2,604	2,742	3.1	949	1,746	28	3	16
- non-conforming	599	949	—	—	1,548	3.7	1,070	379	99	—	—
- commercial	641	194	—	36	871	14.7	25	3	840	—	3
Other	121	670	298	1,176	2,265	2.3	170	249	950	896	—
	3,314	9,142	9,542	5,368	27,366	1.9	16,856	5,227	4,193	1,071	19
2008											
Auto loans	801	1,706	7,402	398	10,307	1.7	6,075	883	3,349	—	—
Corporate loans	1,714	4,347	3,289	2,122	11,472	4.9	10,767	132	573	—	—
Credit card receivables	633	—	4,999	212	5,844	0.7	3,465	62	2,171	146	—
Trade receivables	68	922	1,371	384	2,745	0.7	120	1,025	1,600	—	—
Student loans	144	—	2,411	—	2,555	0.3	2,296	144	115	—	—
Consumer loans	708	1,195	468	—	2,371	1.7	387	993	923	68	—

Mortgages											
- prime	—	2,244	—	4,422	6,666	2.8	2,675	3,876	115	—	—
- non-conforming	960	1,221	—	—	2,181	4.6	351	368	475	987	—
- commercial	713	453	74	495	1,735	11.0	274	518	474	469	—
Other	166	1,198	684	1,933	3,981	1.2	3	958	2,786	234	—
	5,907	13,286	20,698	9,966	49,857	3.0	26,413	8,959	12,581	1,904	—

Asset Protection Scheme*

All the disclosures in this section (pages 161 to 164) are unaudited and are marked with an asterisk (*).

References to 'Group' in this section relate to 'Group before RFS MI'.

Key aspects of the Scheme

On 22 December 2009, the Group acceded to the Asset Protection Scheme (APS or ‘the Scheme’) with HM Treasury (HMT) acting on behalf of the UK Government. Under the Scheme, the Group purchased credit protection over a portfolio of specified assets and exposures ("covered assets") from HMT. The portfolio of covered assets had a par value of approximately £282 billion at 31 December 2008 and the protection is subject to a first loss of £60 billion and covers 90% of subsequent losses net of recoveries. Once through the first loss, when a covered asset has experienced a trigger event losses and recoveries in respect of that asset are included in the balance receivable under APS. Receipts from HMT will, over time, amount to 90% of cumulative losses (net of cumulative recoveries) on the portfolio of covered assets less the first loss amount.

The Group has the right to terminate the Scheme at any time provided that the Financial Services Authority has confirmed in writing to HMT that it has no objection. On termination, the Group is liable to pay HMT a termination fee. The termination fee comprises the difference between £2.5 billion (or, if higher, a sum related to the economic benefit of regulatory capital relief obtained from APS) and the aggregate fees paid. In addition, the Group would have to repay any amounts received from HMT under the terms of APS. In consideration for the protection provided by the APS, the Group paid an initial premium of £1.4 billion on 31 December 2009. A further premium of £700 million was paid on 31 December 2010. Quarterly premiums of £125 million are payable from 31 December 2011 and subsequently until the earlier of 31 December 2099 and the termination of the agreement.

Losses are recognised when a covered asset has experienced a trigger event which comprises of failure to pay subject to grace periods, bankruptcy and restructuring.

APS assets are spread across the Group’s main divisions. High volume commercial and retail exposures were selected on a portfolio basis where assets were high risk and in arrears at 31 December 2008. Large corporate and GBM exposures were selected at the counterparty/asset level based on individual risk reviews and defaulted assets in the workout/restructuring unit.

HMT has the right to appoint step-in managers to carry out any oversight, management or additional functions on behalf of HMT to ensure that the covered assets are managed and administered in compliance with the agreed terms and conditions. This right is exercisable if certain step-in triggers occur. These include:

- losses on covered assets in total exceed 125% of the first loss amount or losses on an individual covered asset class exceed specified thresholds;
- a breach of specified obligations in the APS rules or the accession agreement;
- the Group has failed or is failing to comply with any of the conditions in the APS rules in relation to asset management, monitoring and reporting, and governance and oversight, and such failure is persistent and material or it is evidence of a systematic problem; and

- material or systematic data deficiencies in the information provided to HMT in accordance with the terms of the APS.

HMT may at any time elect to cease to exercise its step-in rights in whole or part when it is satisfied that the step-in triggers have been remedied.

* unaudited

Risk management: Asset Protection Scheme* continued
Covered assets: roll forward to 31 December 2010

The table below details the movement in covered assets in the year.

	£bn
Covered assets at 1 January 2009	282.0
Disposals	(3.0)
Non-contractual early repayments	(8.9)
Maturities and amortisation	(26.1)
Rollovers and covered amount cap adjustments	(1.7)
Effect of foreign currency movements and other adjustments	(11.8)
Covered assets at 31 December 2009	230.5
Disposals	(9.7)
Maturities, amortisation and early repayments	(28.7)
Reclassified assets (2)	3.1
Withdrawals	(2.9)
Effect of foreign currency movements and other adjustments	2.4
Covered assets at 31 December 2010	194.7

Notes:
(1) The Asset Protection Agency (APA) and the Group have now reached agreement on substantially all eligibility issues.
(2) In Q2 2010, the APA and the Group reached agreement over the classification of some structured credit assets which resulted in adjustments to the covered amount, without affecting the underlying risk protection.

Key points
- The reduction in covered assets was due to run-off of the portfolio, disposals, early repayments and maturing loans.

- As part of the Group’s risk reduction strategy significant disposals were made from the Structured Credit Portfolio (2010 - £3.0 billion). The Group took advantage of market conditions and executed sales from its derivative, loan and leveraged finance portfolios (2010 - £6.7 billion).

Credit impairments and write downs
The table below analyses the cumulative credit impairment losses and adjustments to par value (including AFS reserves) relating to the covered assets.

	2010	2009	2008
	£m	£m	£m
Loans and advances	18,033	14,240	7,705
Debt securities	11,747	7,816	7,942
Derivatives	2,043	6,834	6,575
	31,823	28,890	22,222
By division:			
UK Retail	2,964	2,431	1,492
UK Corporate	1,382	1,007	285

Ulster Bank	804	486	234
Retail & Commercial	5,150	3,924	2,011
Global Banking & Markets	1,496	1,628	1,640
Core	6,646	5,552	3,651
Non-Core	25,177	23,338	18,571
	31,823	28,890	22,222

Key points

- The increase in Non-Core impairments of £1.8 billion accounted for the majority of the increase in credit impairments and write downs in 2010.

- The APA and the Group reached agreement for the purposes of the Scheme, on the classification of some structured credit assets which has resulted in adjustments to credit impairments and write downs mainly between debt securities and derivatives.

- The reduction in GBM is largely a result of transfers to Non-Core in the second half of the year.

* unaudited

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Risk management: Asset Protection Scheme* continued

First loss utilisation
The triggered amount is equivalent to the aggregate outstanding principal amount on the trigger date excluding interest, fees, premium or any other non-principal sum that is accrued or payable, except where it was capitalised on or before 31 December 2008. At the trigger date, in economic terms, there is an exchange of assets, with the Group receiving a two year interest-bearing government receivable in exchange for the asset.

APS recoveries include any return of value on a triggered asset, although these are only recognised for the Scheme reporting purposes when they are realised in cash. The net triggered amount at any point in time only takes into account cash recoveries to date. As with any bespoke and highly complex legal agreement there are various areas of interpretation, some of which could have a material impact on the net triggered amount identified to date.

The Scheme rules are designed to allow for data correction over the life of the Scheme.

The table below summarises the triggered amount and related cash recoveries by division.

	2010			2009		
	Triggered amount £m	Cash recoveries to date £m	Net triggered amount £m	Triggered amount £m	Cash recoveries to date £m	Net triggered amount £m
UK Retail	3,675	455	3,220	3,340	129	3,211
UK Corporate	4,640	1,115	3,525	3,570	604	2,966
Ulster Bank	1,500	160	1,340	704	47	657
Retail & Commercial	9,815	1,730	8,085	7,614	780	6,834
Global Banking & Markets	2,547	749	1,798	1,748	108	1,640
Core	12,362	2,479	9,883	9,362	888	8,474
Non-Core	32,138	4,544	27,594	18,905	777	18,128
	44,500	7,023	37,477	28,267	1,665	26,602
Loss credits			1,241			—
			38,718			26,602

Notes:
(1) The triggered amount on a covered asset is calculated when an asset is triggered (due to bankruptcy, failure to pay after a grace period or restructuring with an impairment) and is the lower of the covered amount and the outstanding amount for each covered asset. The Group expects additional assets to trigger upon expiry of relevant grace periods based on the current risk rating and level of impairments on covered assets.
(2) Following the reclassification of some structured credit assets from derivatives to debt securities, the APA and the Group also reached agreement on an additional implied write down trigger in respect of these assets. This occurs if (a) on two successive relevant payment dates, the covered asset has a rating of Caa2 or below by Moody's, CCC or below by Standard & Poor's or Fitch or a comparable rating from an internationally recognised credit rating agency and/or (b) on any two successive relevant payment dates, the mark-to-market value of the covered asset is equal to or less than 40 per cent of the par value of the covered asset, in each case as at such relevant payment date.
(3) Under the Scheme rules, the Group may apply to the APA for loss credits in respect of the disposal of non-triggered assets. A loss credit counts towards the first loss threshold and is typically determined by the APA

based on the expected loss of the relevant asset.

(4) The Group and the APA remain in discussion with regard to loss credits in relation to the withdrawal of £2.0 billion of derivative assets during Q2 2010 and the disposal of approximately £1.6 billion of structured finance and leveraged finance assets in 2010.

(5) The Scheme rules contain provision for on-going revision of data.

Key points

- The Group received loss credits in relation to some of the withdrawals and disposals of £1.2 billion in 2010.

- The Group currently expects recoveries on triggered amounts to be approximately 45% over the life of the relevant assets. On this basis, the expected loss on triggered assets at 31 December 2010 is approximately £25 billion (42%) of the £60 billion first loss threshold under APS.

* unaudited

Risk management: Asset Protection Scheme* continued

Risk-weighted assets

The table below analyses by division, risk-weighted assets (RWAs) covered by APS.

	2010 £bn	2009 £bn
UK Retail	12.4	16.3
UK Corporate	22.9	31.0
Ulster	7.9	8.9
Retail & Commercial	43.2	56.2
Global Banking & Markets	11.5	19.9
Core	54.7	76.1
Non-Core	50.9	51.5
APS RWAs	105.6	127.6

Key points

- The decrease of £22.0 billion in RWAs reflects disposals and early repayments as well as changes in risk parameters.

- In Non-Core, disposals and early repayments were offset by changes in risk parameters.

* unaudited

Governance Contents

Board of directors and secretary

Chairman

Philip Hampton (age 57)
N (Chairman)
Appointed to the Board on 19 January 2009 and to the position of Chairman on 3 February 2009. Philip Hampton was previously chairman of J Sainsbury plc and group finance director of Lloyds TSB Group plc, BT Group plc, BG Group plc, British Gas and British Steel plc, an executive director of Lazards and a non-executive director of RMC Group plc. He is also former chairman of UK Financial Investments Limited which manages the UK Government's shareholding in banks. He is currently a non-executive director of Anglo American plc.

Key to pictures
1. Philip Hampton, Chairman
2. Stephen Hester, Group Chief Executive
3. Bruce Van Saun, Group Finance Director
4. Colin Buchan
5. Sandy Crombie
6. Penny Hughes
7. Joe MacHale
8. John McFarlane
9. Brendan Nelson 10. Arthur 'Art' Ryan 11. Philip Scott 12. Aileen Taylor

Abbreviations
A Member of the Audit Committee N Member of the Nominations Committee R Member of the Remuneration Committee Ri Member of the Board Risk Committee
* Independent non-executive director

Executive directors

Stephen Hester (age 50)
Group Chief Executive
Appointed to the Board on 1 October 2008 and to the position of Group Chief Executive on 21 November 2008, Stephen Hester was chief executive of The British Land Company PLC. He was previously chief operating officer of Abbey National plc and prior to that he held positions with Credit Suisse First Boston including Chief Financial Officer, Head of Fixed Income and co-Head of European Investment Banking. From February 2008 to October 2008 he served as a non-executive deputy chairman of Northern Rock plc. He is also a trustee of The Foundation and Friends of the Royal Botanical Gardens, Kew.

Bruce Van Saun (age 53)
Group Finance Director
Appointed to the Board on 1 October 2009, Bruce Van Saun has more than 25 years financial services experience. From 1997 to 2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as vice chairman and chief financial officer and before that he was responsible for the Asset Management and Market Related businesses. Prior to that, he held senior positions with Deutsche Bank, Wasserstein Perella Group and Kidder Peabody and Co. He has served on several corporate boards as a non-executive director and has been active in numerous community organisations.

Group Secretary

Aileen Taylor (age 38)
Aileen Taylor assumed the role of Group Secretary in May 2010 and provides secretariat and corporate governance advice and support to the Group Board and its senior Committees. Aileen was appointed Deputy Group Secretary and Head of Group Secretariat in 2007, and prior to that held various legal, secretariat and risk roles at divisional and business level. Aileen is a Fellow of the Chartered Institute of Bankers in Scotland and a Fellow of the Industry and Parliament Trust.

Governance

Non-executive directors

Colin Buchan* (age 56) A, N, Ri
Appointed to the Board in June 2002, Colin Buchan was educated in South Africa and spent the early part of his career in South Africa and the Far East. He has considerable international investment banking experience, as well as experience in very large risk management in the equities business. He was formerly a member of the group management board of UBS AG and head of equities of UBS Warburg, and was the former chairman of UBS Securities Canada Inc. He is chairman of Standard Life Investments Limited and a director of Standard Life plc and Black Rock World Mining Trust Plc. Colin is a fellow of the Chartered Institute of Bankers of Scotland.

Sandy Crombie* (age 62) Senior Independent Director, N, R, Ri
Appointed to the Board in June 2009, Sandy Crombie was previously Group Chief Executive of Standard Life Plc. He was also previously a director of the Association of British Insurers and a member of the Chancellor of the Exchequer's High Level Group. In 2007, he was the Prince of Wales' Ambassador for Corporate Social Responsibility in Scotland. He currently serves as Chairman of the Edinburgh UNESCO City of Literature Trust and Creative Scotland, as Vice Chairman of the Board of Governors of the Royal Scottish Academy of Music and Drama, and President of The Cockburn Association.

Penny Hughes* (age 51) N, R (Chair)
Penny Hughes joined the Board on 1 January 2010 and is currently a non-executive director of Home Retail Group plc, Cable and Wireless Worldwide plc and Wm Morrison Supermarkets plc. She is a former non-executive director of Gap Inc, Vodafone PLC and Reuters PLC. Penny chairs the Remuneration Committee of Home Retail Group. Penny was a director and chairman of the Remuneration Committee of Skandinaviska Enskilda Banken AB until she stepped down on 20 October 2009. Penny spent the majority of her executive career at Coca-Cola where she held a number of leadership positions. In 1992, she was appointed as President, Coca-Cola Great Britain and Ireland. She is also a Trustee of the British Museum and President of the Advertising Association.

Joe MacHale* (age 59) N, Ri
Appointed to the Board in September 2004, Joe MacHale is currently a non-executive director and chairman of the remuneration committee of Brit Insurance Holdings plc, and a trustee and treasurer of MacMillan Cancer Support. He held a number of senior executive positions with J P Morgan between 1979 and 2001 and was latterly chief executive of J P Morgan Europe, Middle East and Africa Region. He is a fellow of the Institute of Chartered Accountants and the Chairman of Prytania Group.

John McFarlane* (age 63) N, R
Appointed to the Board on 1 October 2008, John McFarlane is former chief executive officer of Australia and New Zealand Banking Group Limited. Previously he was a group executive director of Standard Chartered and was head of Citicorp/Citibank in the UK and Ireland. He is currently a non-executive director of Westfield Holdings Limited and a director of Old Oak Holdings Limited. He is a former president of the International Monetary Conference and a former chairman of the Australian Bankers Association. He has previously served as a director of the London Stock Exchange and a member of the Auditing Practices Board.

Brendan Nelson* (age 61) A (Chairman), N, Ri

Appointed to the Board on 1 April 2010, Brendan Nelson is the former global chairman, Financial Services for KPMG. Previously, he held a range of senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 until 2006 and as vice chairman from 2006. He has been a board member of the Financial Services Skills Council since 2008 and was chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland from 2005 until 2008. He joined the Board of BP plc in November 2010.

Arthur 'Art' Ryan* (age 68) N
Appointed to the Board on 1 October 2008, Art Ryan is the former chairman, chief executive officer and president of Prudential Financial Inc. Previously he held senior positions with Chase Manhattan Bank NA. He is currently a non-executive director of Regeneron Pharmaceuticals Inc. and an active member of numerous community boards. He was a founding member of the Financial Services Forum.

Philip Scott* (age 56) A, N, Ri (Chairman)
Appointed to the Board on 1 November 2009, Philip Scott has wide-ranging experience of financial services and risk management, including previous responsibility for Aviva's continental European and international life and long-term savings businesses. He held a number of senior executive positions during his career at Aviva, including his role as Group Finance Director until January 2010.-Philip is also an experienced non-executive director and is currently on the board of Diageo plc. He is a Fellow of the Institute of Actuaries and The Association of Certified Public Accountants.

The Executive Committee provides executive input to the Group Board, and monitors and reports to the Group Board on all operational and day to day activities in relation to the Group's businesses.

It is responsible for managing Group wide issues and those operational issues material to the broader Group.

Key to pictures
1 Stephen Hester, Group Chief Executive
2 Bruce Van Saun, Group Finance Director
3 Ellen Alemany, Chief Executive, Citizens and Head of Americas
4 Nathan Bostock, Head of Restructuring and Risk
5 Paul Geddes, Chief Executive, RBS Insurance
6 Brian Hartzer, Chief Executive, UK Retail, Wealth and Ulster Bank
7 John Hourican, Chief Executive, Global Banking and Markets
8 Chris Sullivan, Chief Executive, UK Corporate
9 Ron Teerlink, Chief Administrative Officer

Governance

Executive Committee

Stephen Hester, Group Chief Executive

Bruce Van Saun, Group Finance Director M For biographies see page166

Ellen Alemany (age 55)
Chief Executive, Citizens and Head of Americas
Ellen Alemany joined the RBS Group in June 2007 as Chief Executive Officer of Citizens Financial Group, Inc. and Head of RBS Americas. She became Chairman of Citizens Financial Group, Inc. in March 2009. Prior to this appointment, Ellen was the CEO for Global Transaction Services at Citigroup, one of Citi's 12 publicity reported product lines. Ellen joined Citibank in 1987 and has held various positions including EVP for Commercial Business Group, Chairman and CEO for Citibank International plc and Citibank's European Bank.

Nathan Bostock (age 50) Head of Restructuring and Risk
Nathan Bostock joined the RBS Group in June 2009 as Head of Restructuring and Risk with responsibility for the Non-Core Division and APS, the Global Restructuring Group and the control functions of Group Legal and Secretariat and Risk Management. Before joining RBS, Nathan spent eight years with Abbey National plc in several roles and was latterly the CFO and main Board Director responsible for Products and Marketing, HR, Insurance and Cards. Before joining Abbey in 2001, Nathan spent ten years with RBS in a number of roles, including Chief Operating Officer of Treasury and Capital Markets and Group Risk Director. A Chartered Accountant, Nathan worked with Coopers and Lybrand, before starting his career in banking. He spent seven years in Chase Manhattan Bank in a variety of areas and functions. He also holds a BSc (Hons) in Mathematics.

Paul Geddes (age 41)
Chief Executive, RBS Insurance
Paul Geddes graduated from Oxford in 1990, where he read Politics, Philosophy and Economics. His career started at Procter and Gamble, in the UK and Europe. He entered retailing in 1997, holding senior roles in Kingfisher and GUS Groups before joining the RBS Group in 2004 as Managing Director, Products and Marketing, Retail Banking. He was appointed CEO, Retail Banking in December 2006 and CEO, UK Retail in February 2009, before taking overall responsibility for some of the UK's best-known insurance brands, including Direct Line, Churchill, Privilege and Green Flag as CEO, RBS Insurance in August 2009. Paul is a Fellow of the Chartered Institute of Bankers in Scotland.

Brian Hartzer (age 44)
Chief Executive, UK Retail, Wealth and Ulster Bank
Brian Hartzer has been the Chief Executive Officer for Retail, Wealth and Ulster Bank since August 2009. He joined RBS from ANZ in Australia, where he was Chief Executive Officer Australia, as well as Global Segment Lead for Retail and Wealth. Brian joined ANZ in 1999 as Managing Director, Consumer Finance, and later ran ANZ's Personal Banking division. Prior to joining ANZ, Brian spent ten years as a financial services consultant in New York, San Francisco, and Melbourne. Brian is a graduate of Princeton University and holds joint US and Australian citizenship.

John Hourican (age 40)
Chief Executive, Global Banking and Markets
John Hourican was appointed Chief Executive of Global Banking and Markets in October 2008. Prior to this John held a variety of positions across the RBS

Group, including CFO of ABN AMRO Group, Head of Leveraged Finance and Chief Operating Officer of Global Banking and Markets. John was educated at the National University of Ireland and received his Postgraduate Diploma from Dublin City University before starting his career at Price Waterhouse, where he worked in Dublin, London and Hong Kong. He is a fellow of the Institute of Chartered Accountants in Ireland.

Chris Sullivan (age 53) Chief Executive, UK Corporate
Chris Sullivan was appointed Chief Executive of the UK Corporate Banking Division and the GTS Division in August 2009. His previous role was Chief Executive of RBS Insurance, the second largest general insurance provider in the UK. Prior to this, Chris was Chief Executive of Retail and Deputy Chief Executive of Retail Markets. Chris is Vice Chairman of the Association of British Insurers, Chairman of the General Insurance Council and a member of the CBI President's Committee. He spent five years as Chief Executive of Lombard Asset Finance and under his leadership it attained a leading position in the UK and Europe. Chris Sullivan earned his Fellowship of Chartered Institute of Bankers Scotland for his services to Scottish Banking.

Ron Teerlink (age 50) Chief Administrative Officer
In April 2008, Ron Teerlink joined the RBS Group as Chief Executive of Business Services, becoming the Group Chief Administrative Officer in February 2009. At the same time he was re-appointed to the Managing Board of ABN AMRO to oversee the integration programme. Ron started his career with ABN Bank in 1986 as an IT/Systems analyst and held various functional positions before becoming Chief Operating Officer of the Wholesale Clients Business in 2002. He was appointed Chief Executive Officer of Group Shared Services in 2004 and joined ABN AMRO's Managing Board in January 2006, where he was responsible for Services and Market Infrastructure. Ron holds a Masters degree in Economics from Amsterdam's Vrije Universiteit.

Management Committee

The Management Committee, comprising our major business and functional leaders, meets three to four times annually as a vehicle for strategy and business performance review.

It comprises members of the Executive Committee plus:

Elaine Arden, Group Human Resources Director
Scott Barton, Chief Executive, Global Transaction Services Chris Campbell, Group General Counsel
Mark Catton, Chief Executive, UK Corporate and Institutional Banking Rory Cullinan, Head of Non-Core Division John Cummins, Group Treasurer Jennifer Hill, Group Director -- Strategy and Corporate Finance Suneel Kamlani, President of Global Banking and Markets Marco Mazzucchelli, Global Head of Banking and Deputy CEO, GBM Cormac McCarthy, Chief Executive, Ulster Bank John McCormick, Chief Executive, GBM Asia Pacific Andrew McLaughlin, Head of Communications and Group Chief Economist Peter Nielsen, Global Head of Markets David Stephen, Deputy Group Chief Risk Officer Brian Stevenson, Chairman, Global Transaction Services Rory Tapner, Chief Executive, Wealth Management

The directors present their report together with the audited accounts for the year ended 31 December 2010.

Group structure

The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc, the principal direct operating subsidiary undertaking of the company. The Group comprises the company and all its subsidiary and associated undertakings, including the Royal Bank and NatWest. Details of the principal subsidiary undertakings of the company are shown in Note 18 on the accounts.

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

During the year, the company converted certain non-cumulative convertible preference shares into ordinary shares in the company. As a result, HM Treasury's holding in the company's ordinary shares reduced to 67.8%.

Results and dividends

The loss attributable to the ordinary and B shareholders of the company for the year ended 31 December 2010 amounted to £1,125 million compared with a loss of £3,607 million for the year ended 31 December 2009, as set out in the consolidated income statement on page 209.

The company did not pay a dividend on ordinary shares in 2009 or 2010.

The Group has undertaken that, unless otherwise agreed with the European Commission, neither the company nor any of its direct or indirect subsidiaries (other than companies in the RBS Holdings N.V. group, which are subject to different restrictions, see below) will pay external investors any dividends or coupons on existing hybrid capital instruments (including preference shares, B shares and upper and lower tier 2 instruments) for a period of two years from 30 April 2010 (the "Deferral Period"), or exercise any call rights in relation to these capital instruments between 24 November 2009 and the end of the Deferral Period, unless there is a legal obligation to do so. Hybrid capital instruments issued after 24 November 2009 will generally not be subject to the restriction on dividend or coupon payments or call options.

The Group has agreed that RBS Holdings N.V. will not pay investors any coupons on, or exercise any call rights in relation to, specified hybrid capital instruments for an effective period of two years from 1 April 2011, unless in any such case there is a legal obligation to do so. RBS Holdings N.V. and its group companies are also subject to restrictions on the exercise of call rights in relation to their other hybrid capital instruments.

Business review

Activities

The Group is engaged principally in providing a wide range of banking, insurance and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its divisions and the competitive markets in which they operate, are contained in the Business review on pages 5 and 6.

Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Certain risk factors the Group faces are summarised on page 7.

Fuller details of these and other risk factors are set out on pages 352 to 369.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 216 to 227.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Risk and balance sheet management section of the Business review on pages 59 to 164.

Financial performance
A review of the Group's performance during the year ended 31 December 2010, including details of each division, and the Group's financial position as at that date is contained in the Business review on pages 8 to 58.

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

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

Legal separation of ABN AMRO Bank N.V. occurred on 1 April 2010, with the shares in that entity being transferred by ABN AMRO Holding N.V (renamed RBS Holdings N.V. at legal separation) to a holding company called ABN AMRO Group N.V., which is owned by the Dutch State. Following legal separation, RBS Holdings N.V. has one direct subsidiary, The Royal Bank of Scotland N.V. ("RBS N.V."), a fully operational bank within the Group. RBS N.V. is independently rated and regulated by the Dutch Central Bank. Certain assets within RBS N.V. continue to be shared by the Consortium Members.

The shareholdings of RFS Holdings B.V. were amended on 31 December 2010, resulting in approximately 98% of its issued share capital now being held by the Group.

Business divestments

Significant progress has been made on the Group's European Commission-mandated disposal programme, with three of the four disposals largely agreed. In August 2010, agreement was reached on the sale of the Group's RBS branches in England and Wales and NatWest branches in Scotland to Santander UK plc. The sale remains subject to regulatory and other approvals.

The sale of 80.01% of the Global Merchant Services ("GMS") business to a consortium of Advent International and Bain Capital completed in November 2010. The Group holds a 19.99% minority stake in the new GMS business, to be known as WorldPay.

The sale of RBS Sempra Commodities' Metals, Oil and European Energy business lines to J.P.Morgan completed in July 2010. The sale of Sempra Energy Solutions to Noble Americas Gas & Power Corp completed in November 2010, while the sale of Sempra North American Power and Gas to J.P.Morgan completed in December 2010.

Employees

As at 31 December 2010, the Group employed over 148,500 employees (full-time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the accounts.

Employee learning and development

The Group maintains a strong commitment to creating and providing learning opportunities for all its employees through a variety of personal development, training programmes, learning networks and targeted leadership programmes. Employees are also encouraged to do voluntary work with community partners.

Employee communication

Employee engagement is encouraged through a range of communication channels, at both divisional and Group level. These channels provide access to news and information in a number of ways, including the intranet, magazines, video, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Group Chief Executive and other senior Group executives regularly communicate with, and encourage feedback from, employees across a range of channels.

Employee consultation

Each year, all employees are invited to complete the global employee opinion survey. The survey is confidential and independently managed by Towers Watson. The survey provides a channel for employees to express their views and opinions about the Group on a range of key issues.

The 2010 survey took place in September 2010 and the final response rate was 81%. This represents over 119,000 employees participating in the survey, from more than 50 countries.

The Group recognises employee representative organisations such as trade unions and work councils in a number of businesses and countries.

The Group has two European employee fora that provide elected representatives with an opportunity to understand better its European operations. Engagement with its employees and such bodies remains important to the Group.

Diversity and inclusion

The Group recognises that the diversity of its workforce is a significant and necessary asset to the business. During 2010, the Group executive renewed its commitment to ensuring a working environment that is inclusive to all and one that will enable all employees to develop to their full potential.

The Group has a range of policies and processes that extend through the employee life-cycle including recruitment, flexible working and support for ill-health and disability-related absence. Diversity performance is monitored and reviewed at Group and divisional executive level. This commitment extends beyond the Group including support of external charitable networks and fora and as part of the community engagement and supplier relationships. Internally, the Group supports initiatives such as the Women in Business network.

Safety, health and wellbeing

Ensuring the safety, health and wellbeing of employees and customers is core to the Group's business, and a fundamental social responsibility for the Group.

During 2010, the Group continued to focus on compliance, governance and managing risk across all jurisdictions. Enhanced services and supporting communication were implemented to support the health and wellbeing of employees, particularly given the impact of the economic environment.

Pre-employment screening

The Group has a comprehensive pre-employment screening process to guard against possible infiltration and employee-related fraud for all direct and non-direct staff engaged on Group business.

Code of conduct

The code of conduct applies to all employees globally and to all those engaged by the Group, but who are not employees, such as contractors and those engaged through external agencies.

The code of conduct exists to promote honest and ethical conduct, including the handling of actual or apparent conflicts of interest between personal and professional relationships. The Group recognises that personal conduct, business integrity and the Group's security are crucial, and the code of conduct serves to inform employees of the Group's expectations of their behaviour and practices.

Sustainability
Sustainability is central to the way the Group is managed. Sustainability is not just about the many responsibilities and obligations that the Group has in a legal sense, but about specific issues that need to be addressed to ensure that the Group is a healthy and respected business operating on a sustainable basis. There is a clear governance structure for Group Sustainability that oversees and aligns the Group's approach to the range of social, ethical and environmental issues which confront the business on a daily basis.

The Group continues to do significant work and address challenges across five key themes: Fair banking, Supporting enterprise, Employee engagement, Safety and security, and Citizenship and environmental sustainability.

Going concern
The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Business review. The risk factors which could adversely affect the Group's future results are set out on pages 352 to 369. The Group's regulatory capital resources and significant developments since 2009 and anticipated future developments are detailed in the Capital section on pages 66 to 73. The Funding and liquidity risk section, pages 74 to 82, describes the Group's funding and liquidity profile, including changes in key metrics, the build up of liquidity reserves and the outlook for 2011.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

BBA disclosure code
In September 2010, the British Bankers' Association published its Code for Financial Reporting Disclosure. The code sets out five disclosure principles together with supporting guidance. The principles are that the Group and other major UK banks will provide high quality, meaningful and decision-useful disclosures; review and enhance their financial instrument disclosures for key areas of interest to market participants; assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; seek to enhance the comparability of financial statement disclosures across the UK banking sector; and clearly differentiate in their annual reports between information that is audited and information that is unaudited. The Group's 2010 financial statements have been prepared in compliance with the code's principles.

Corporate governance
The company is committed to high standards of corporate governance. Details are given on pages 175 to 186. The corporate governance statement forms part of this Report of the directors.

Share capital
Details of the ordinary share capital and preference share capital at 31 December 2010 and movements during the year, are shown in Note 29 on the accounts.

Additional information
Where not provided elsewhere in the Report of the directors, the following additional information is required to be disclosed by Part 6 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The rights and obligations attaching to the company's ordinary shares and preference shares are set out in the company's Articles of Association, copies of which can be obtained from Companies House in the UK or at www.rbs.com.

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares present in person or by proxy and entitled to vote shall have one vote for every share held. On a poll, holders of cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held. The voting rights of holders of non-cumulative preference shares are set out in Note 29 on the accounts. The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.01% and the non-cumulative preference shares represent less than 0.73% of the total voting rights of the company respectively, the remainder being represented by the ordinary shares.

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws). Pursuant to the Listing Rules of the Financial Services Authority (FSA), certain employees of the company require the approval of the company to deal in the company’s shares.

The rules governing the appointment of directors are set out in the company’s Articles of Association and on page 176. The company’s Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

A number of the company's share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

The rights and obligations of holders of non-cumulative preference shares are set out in Note 29 on the accounts.

Except in relation to the Dividend Access Share, the company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank and Ulster Bank Dublin Trust Company as Trustees. Voting rights are exercised by the Trustees on receipt of participants' instructions. If a participant does not submit an instruction to the Trustee no vote is registered.

The Royal Bank of Scotland plc 1992 Employee Share Trust, The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of the Group's employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.

Awards granted under the company's employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company's employee benefit trusts.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company's employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

Directors

The names and brief biographical details of the directors are shown on pages 166 and 167.

Colin Buchan, Sandy Crombie, Philip Hampton, Stephen Hester, Penny Hughes, Joe MacHale, John McFarlane, Art Ryan, Philip Scott and Bruce Van Saun all served throughout the year and to the date of signing of the financial statements.

Gordon Pell retired as an executive director on 31 March 2010.

Brendan Nelson was appointed as a non-executive director on 1 April 2010.

Archie Hunter retired as a non-executive director on 28 April 2010.

All directors of the company will stand for re-election by shareholders at the 2011 Annual General Meeting and annually thereafter. Colin Buchan will stand down as a non-executive director on 5 August 2011 following the announcement of the Group's interim results, having served just over nine years on the Board.

Group General Counsel and Group Secretary

Miller McLean retired as Group General Counsel and Group Secretary on 30 April 2010. He was succeeded by Chris Campbell as Group General Counsel and Aileen Taylor as Group Secretary.

Directors' interests

The interests of the directors in the shares of the company at 31 December 2010 are shown on page 205. None of the directors held an interest in the loan capital of the company or in the shares or loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2010 to 23 February 2011.

Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the company to directors, members of the Group's Executive and Management Committees and FSA Approved Persons.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Group's pension schemes.

Post balance sheet events

There have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Shareholdings

The table below shows shareholders that have notified the Group that they hold more than 3% of the total voting rights of the company at 31 December 2010.

Solicitor For The Affairs of Her Majesty's Treasury as Nominee for Her Majesty's Treasury	Number of shares	% held
Ordinary shares	39,644,835,194	67.8
B shares (non-voting)	51,000,000,000	100.0

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Charitable contributions

In 2010, the Group’s overall community contribution was £56.1 million (2009 - £63.9 million). The total amount given for charitable purposes by the company and its subsidiary undertakings during the year ended 31 December 2010 was £29.6 million (2009 - £34.7 million).

To ensure it makes its community investments as effective as possible, the Group’s policy is to focus its resources on a small number of substantial strategic programmes. These are issues most relevant to a financial institution and relate broadly to financial education, supporting enterprise and microfinance and the charitable endeavours of employees.

Political donations

At the Annual General Meeting in 2010, shareholders gave authority under Part 14 of the Companies Act, for a period of one year, for the company (and its subsidiaries) to make political donations and incur political expenditure up to a maximum aggregate sum of £500,000. This authorisation was taken as a precaution only, as the company has a longstanding policy of not making political donations or incurring political expenditure within the ordinary meaning of those words. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2011.

During 2010, the Group made no political donations in the UK or EU. In keeping with the Group’s employment policies, Coutts & Company allowed a member of staff paid leave during the year to stand for election at the UK General Election. This might constitute political expenditure for the purposes of the Companies Act, as the definition in the Companies Act is capable of having a very wide meaning. The amount of expenditure in relation to the paid leave was £2,128.

RBS Services Australia Limited, a company acquired by the Group through its acquisition of ABN AMRO, made donations of AUS$126,552 (£75,397) during 2010 to Australian political parties and Australian party-affiliated fundraising vehicles. These payments were fully compliant with ABN AMRO policy and Australian electoral law. No further donations will be made and it is not proposed that the Group’s longstanding policy of not making contributions to any political party be changed.

Policy and practice on payment of creditors

The Group is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Group’s policy to negotiate and agree terms and conditions with its suppliers, which include the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

At 31 December 2010, the Group’s trade creditors represented 29 days (2009 - 30 days) of amounts invoiced by suppliers.

Directors’ disclosure to auditors

Each of the directors at the date of approval of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the company’s auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company’s auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

Auditors
The auditors, Deloitte LLP, have indicated their willingness to continue in office. A resolution to re-appoint Deloitte LLP as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor
Secretary
23 February 2011

The Royal Bank of Scotland Group plc
is registered in Scotland No. 45551

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The company is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 December 2010, the company has complied with all of the provisions of the Combined Code issued by the Financial Reporting Council in June 2008 (the "Code") except in relation to the provision that the Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. The company considers that this is a matter which should rightly be reserved for the Board. No director is involved in decisions regarding his or her own remuneration.

Although not applicable to the current accounting period, the company has also complied with the main provisions of the UK Corporate Governance Code issued by the Financial Reporting Council in May 2010 (the “new Code”) except as noted above. The company has also taken steps to implement the recommendations arising from the review of governance in banks and financial institutions undertaken by Sir David Walker (the “Walker Review”), details of which are described in this section. A copy of the new Code can be found at http://www.frc.org.uk/corporate.

The company has also complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in December 2010.

Under the US Sarbanes-Oxley Act of 2002 (the "Act"), specific standards of corporate governance and business and financial disclosures apply to companies with securities registered in the US. The company complies with all applicable sections of the Act.

The New York Stock Exchange
As a foreign issuer with American Depositary Shares representing ordinary shares, preference shares and debt securities listed on the New York Stock Exchange (the “NYSE”), the company must disclose any significant ways in which its corporate governance practices differ from those followed by US companies under the NYSE corporate governance listing standards. In addition, the company must comply fully with the provisions of the listing standards that relate to the composition, responsibilities and operation of audit committees. These provisions incorporate the relevant rules concerning audit committees of the US Securities Exchange Act of 1934 (“Exchange Act”).

The company has reviewed its corporate governance arrangements and is satisfied that these are consistent with the NYSE’s corporate governance listing practices, with the exception that the Chairman of the Board is also the Chairman of the Nominations Committee, which is permitted under the Code (since the Chairman was considered independent on appointment). The company’s Audit, Board Risk, Remuneration and Nominations Committees are otherwise composed solely of non-executive directors deemed by the Board to be independent. The NYSE corporate governance listing standards also require that a compensation committee has direct responsibility to review and approve the Group Chief Executive’s remuneration.

As stated above, in the case of the company, the Board, rather than the Remuneration Committee, reserves the authority to make the final determination of the remuneration of the Group Chief Executive.

The Audit Committee complies with the provisions of the NYSE corporate governance listing standards that relate to the composition, responsibilities and operation of audit committees. In May 2010, the company submitted its required annual written affirmation to the NYSE confirming its full compliance with those and other applicable provisions. More detailed information about the Audit Committee and its work during 2010 is set out in the Audit Committee report on pages 179 to 182.

Board of directors

The Board is the main decision-making forum for the company. It has overall responsibility for management of the business and affairs of the Group, the establishment of Group strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance. The Board considers strategic issues and ensures the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations. The Board has a formal schedule of matters detailing key aspects of the company's affairs reserved to it for its decision. This schedule is reviewed bi-annually.

The roles of Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated by the Board. Responsibility for the development of policy and strategy and operational management is delegated to the Group Chief Executive and the Group Finance Director.

All directors participate in discussing strategy, performance and the financial and risk management of the company. Meetings of the Board are structured to allow sufficient time for consideration of all items and the Chairman encourages constructive challenge and debate.

For 2010, eleven Board meetings were scheduled. Individual attendance at these meetings is set out on page 178. The directors were supplied with comprehensive papers in advance of each Board meeting. The Group Chief Executive provides a written report on business activities at each Board meeting. Members of executive management attend and make regular presentations at meetings of the Board. The Chairman and the non-executive directors meet at least once per year without executive directors present.

The Board is aware of the other commitments of its directors and has established procedures for ensuring that the Board's powers for authorising directors' conflicts of interest are being operated effectively. With effect from 1 October 2008, the Companies Act introduced a statutory duty on directors to avoid conflicts of interest unless authorised. Since that date, the Board has considered, and where appropriate authorised, any actual or potential conflicts of interests that directors may have.

Board balance and independence

The Board currently comprises the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director. The Board functions effectively and efficiently and is considered to be of an appropriate size. The directors provide the Group with the knowledge, mix of skills and experience required. The Board Committees comprise directors with a variety of relevant skills and experience so that no undue reliance is placed on any individual.

The non-executive directors combine broad business and commercial experience with independent and objective judgement. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership and maintain the highest standards of integrity across the Group's business activities.

The Board considers that the Chairman was independent on appointment and all non-executive directors are independent for the purposes of the Code. The standard terms and conditions of the appointment of non-executive directors are available on the Group's website (www.rbs.com) and copies are available on request.

Re-election of directors

In accordance with the provisions of the new Code, all directors of the company will stand for re-election by shareholders at the company's 2011 Annual General Meeting and annually thereafter. Colin Buchan will stand down as a non-executive director on 5 August 2011 following the announcement of the Group's interim results, having served just over nine years on the Board.

The names and biographical details of directors are shown on pages 166 and 167. Further information in relation to the company's Annual General Meeting can be found in the Chairman's letter to shareholders.

Information, induction and professional development

All directors receive accurate, timely and clear information on all relevant matters, and have access to the advice and services of the Group Secretary who is responsible to the Board for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. In addition, all directors are able, if necessary, to obtain independent professional advice at the company's expense.

In line with recommendations of the Walker Review and the new Code, the company has reviewed the induction programme for new directors. Each new director receives a formal induction on joining the Board, including visits to the Group's major businesses and meetings with directors and senior management and key stakeholders. The induction is tailored to the director's specific requirements.

The company has undertaken a comprehensive review of the ongoing professional development programme for directors. Directors are advised of appropriate training and professional development opportunities and undertake the training and professional development they consider necessary in assisting them to carry out their duties as a director.

Performance evaluation

Following the external Board evaluation carried out in 2009, a number of initiatives were implemented aimed at improving the overall performance and effectiveness of the Board, including greater advance planning in relation to Board agendas to allow more in-depth discussion of businesses and enhancement of Board engagement in risk management and setting risk appetite.

A formal and rigorous internal evaluation of the performance of the Board and Nominations Committee during 2010 was carried out by the Group Secretary. A detailed framework of questions was used to structure individual meetings held by the Group Secretary with each director and regular meeting attendees. The Group Secretary then discussed the outcomes and recommendations with the Chairman. Amongst the areas reviewed were the role and organisation of the Board and Board Committees, Board and Committee composition, Board processes, the structure and frequency of meetings, Board performance and reporting, strategy and risk management and external relationships, including those with shareholders and regulators.

The Board has considered and discussed reports on the outcomes of the evaluation and is satisfied with the way in which the evaluation was conducted. The evaluation concluded that the Board is strong and operating effectively, headed by an excellent Chairman, who facilitates good, constructive debate. Generally, the Board is viewed as currently being of the appropriate size and has a good dynamic, although Board composition should be kept under continual review to ensure that the correct balance of skills and experience is maintained, particularly on Board Committees. On the structure of Board meeting agendas it was suggested that greater time could be allocated for discussions on key issues to allow in-depth focus on items which are material to the Group and to encourage an emphasis on debate and discussion rather than formal presentation.

Separate in-depth evaluations were carried out for each of the Audit Committee, Board Risk Committee and Remuneration Committee by the Group Secretary, where appropriate in conjunction with the Committee Chair. Further information on the evaluations carried out in relation to the Audit Committee, Board Risk Committee and Remuneration Committee is set out on pages 182, 186 and 190 respectively.

Additionally, directors were asked to provide feedback on their fellow directors. This feedback was shared with each director by the Chairman, who met with each director individually to discuss their own performance and ongoing professional development.

Separately, the Senior Independent Director canvassed the views of the executive directors and met with the non-executive directors as a group, without the Chairman present, to consider the Chairman's performance. Feedback was sought on governance and stewardship of the Group, relationships with key external and internal stakeholders, execution of the Group's Strategic Plan and delivery of value and return to shareholders. The Senior Independent Director also canvassed views from United Kingdom Financial Investments Limited (UKFI) and the FSA. The results of this were then shared with the Chairman who agreed to consider the points raised and provide separate responses in due course.

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board Committees with particular responsibilities. The Committee chairmanship and membership are reviewed on a regular basis. The names and biographies of all Board Committee members are set out on pages 166 and 167.

The terms of reference of the undernoted committees are available on the Group's website (www.rbs.com) and copies are available on request.

Audit Committee

The Audit Committee is comprised of at least three independent non-executive directors. The Audit Committee held seven scheduled meetings in 2010.

The Audit Committee is responsible for assisting the Board in discharging its responsibilities in relation to the disclosure of the financial affairs of the Group. The Audit Committee reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's system and standards of internal controls, monitors the Group's processes for internal audit and external audit and reviews the practices of the Divisional Risk and Audit Committees. The Audit Committee report is set out on pages 179 to 182.

Board Risk Committee

The Board Risk Committee is comprised of at least three independent non-executive directors. The Board Risk Committee held six scheduled meetings and three additional meetings in 2010.

The Board Risk Committee is responsible for providing oversight and advice to the Board in relation to current and potential future
risk exposures of the Group and future risk strategy, including determination of risk appetite and tolerance. The Board Risk Committee report is set out on pages 185 and 186.

Remuneration Committee

The Remuneration Committee is comprised of at least three independent non-executive directors. The Remuneration Committee held nine scheduled meetings and six additional meetings in 2010.

The Remuneration Committee is responsible for the overview of the Groups remuneration policy and remuneration governance framework, ensuring that remuneration arrangements are consistent with and promote effective risk management. The committee also makes recommendations to the Board on the remuneration arrangements for executive directors.

The Remuneration Report, including a letter from the Chair of the Remuneration Committee, is set out on pages 187 to 204.

Nominations Committee

All non-executive directors are members of the Nominations Committee which is chaired by the Chairman of the Group. The Group Chief Executive is invited to attend meetings. The Nominations Committee holds at least two scheduled meetings per year, and also meets on an ad hoc basis as required.

The Nominations Committee is responsible for:

- assisting the Board in the formal selection and appointment of directors having regard to the overall balance of skills, knowledge, experience and diversity on the Board;

- reviewing the structure, size and composition of the Board and making recommendations to the Board on any appropriate changes;
- reviewing membership and Chairmanship of Group Board Committees; and
- considering succession planning for the Chairman, Group Chief Executive and non-executive directors, taking into account the skills and expertise which will be needed on the Board in the future. No director is involved in decisions regarding his or her own succession.

The Nominations Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board.

Group Sustainability Committee
The Group Sustainability Committee (GSC) was established in 2009 and is chaired by the Senior Independent Director. The GSC is responsible for reviewing the Group's overall sustainability strategy, values and policies and aligning the Group's approach to social, environmental and ethical issues. All key business areas are represented on the GSC and it is attended by the Group Chairman.

Further details of the Group's sustainability policies are available on www.rbs.com/sustainability and in the Annual Sustainability Report.

Meetings

The number of scheduled meetings of the Board and the Audit, Board Risk, Remuneration and Nominations Committees and individual attendance at these meetings by members in 2010 is shown below.

In addition to scheduled meetings, 15 additional meetings of the Board and Committees of the Board were held during 2010, including meetings to consider and approve financial statements. There were also three additional meetings of the Board Risk Committee and six additional meetings of the Remuneration Committee during 2010.

	Board	Audit	Board Risk	Remuneration	Nominations
Total number of scheduled meetings in 2010	11	7	6	9	2
Number of meetings attended in 2010					
Philip Hampton	11				2
Stephen Hester	11				
Colin Buchan (1)	10	6	6	4	2
Sandy Crombie	11		6	9	2
Penny Hughes	11			9	2
Joe MacHale (2)	11	3	5		2
John McFarlane	11			9	2
Brendan Nelson (3)	8	4	3		2
Art Ryan (4)	6				1
Philip Scott	10	7	6		1
Bruce Van Saun	11				
Former directors					
Archie Hunter (5)	4	3	3		
Gordon Pell (6)	2				

Notes:

(1) Stood down from the Remuneration Committee with effect from 1 June 2010.

(2) Stood down from the Audit Committee with effect from 30 April 2010.

(3) Appointed as a director on 1 April 2010.

(4) Unable to attend a number of Board and Committee meetings during 2010 due to family illness.

(5) Ceased to be a director on 28 April 2010.

(6) Ceased to be a director on 31 March 2010.

Relations with shareholders

The company communicates with shareholders through the Annual Report and Accounts and by providing information in advance of the Annual General Meeting. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time throughout the year primarily by letter, telephone or email via the Group’s website (www.rbs.com/ir).

Shareholders are given the opportunity to ask questions at the Annual General Meeting or submit written questions in advance. The chairmen of the Audit, Board Risk, Remuneration and Nominations Committees are available to answer questions at the Annual General Meeting. The Senior Independent Director is also available.

Communication with the company's largest institutional shareholders is undertaken as part of the Investor Relations programme:

- The Group Chief Executive meets regularly with UKFI, the organisation set up to manage the Government's investments in financial institutions, to discuss the strategy and financial performance of the Group. He also undertakes an annual programme of meetings with the company's largest institutional shareholders, as does the Group Finance Director.

- The Chairman independently meets with the Group's largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman, Senior Independent Director and chairs of the Board Committees met with the governance representatives of a number of institutional shareholders during the year.

- The Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels.

- The Chair of the Remuneration Committee consults with institutional shareholders in respect of the Group's remuneration policy.

Throughout the year, the Chairman, Group Chief Executive and Group Finance Director communicate shareholder feedback to the Board and the directors receive independent analyst notes and reports reviewing share price movements and the Group's performance against the sector. Detailed market and shareholder feedback is also provided to the Board after major public announcements such as earnings releases. The arrangements used to ensure that directors develop an understanding of the views of major shareholders are considered as part of the annual Board evaluation.

Audit Committee Report by Brendan Nelson, Chairman

Membership
I assumed the role of Chairman of the Audit Committee on 28 April 2010, following the retirement of Archie Hunter. The current members of the Committee are Colin Buchan, Philip Scott and myself. Joe MacHale stood down from the Audit Committee with effect from 30 April 2010 and is now a member of the Board Risk Committee and Asset Protection Scheme (APS) Senior Oversight Committee.

All members of the Audit Committee are independent non-executive directors. Colin Buchan and Philip Scott served throughout 2010, and I became a member of the Committee with effect from 1 April 2010. Attendance of each member at meetings of the Audit Committee in 2010 is shown on page 178.

The members of the Audit Committee are also members of the Board Risk Committee. This common membership ensures effective governance across all Finance and Risk issues, and that agendas are aligned and overlap is avoided. The Audit and Board Risk Committees also have strong links with the Remuneration Committee, with particular regard to ensuring that relevant Finance and Risk matters are factored into the determination of appropriate levels of compensation.

The Board is satisfied that all Audit Committee members have recent and relevant financial experience, and that each member of the Audit Committee is an 'Audit Committee Financial Expert' and is independent, each as defined in the SEC rules under the Exchange Act and related guidance. I am a Chartered Accountant, a member of the Institute of Chartered Accountants of Scotland and a former Vice Chairman of KPMG in the UK; Philip Scott is a fellow of the Institute of Actuaries and a former Group Finance Director of Aviva plc; and Colin Buchan is a Fellow of the Chartered Institute of Bankers of Scotland and was a member of the group management board at UBS AG. The members of the Audit Committee are selected with a view to the expertise and experience of the Audit Committee as a whole, and the Audit Committee reports to the Board as a single entity.

Responsibilities
The Audit Committee's primary responsibilities are to:

- assist the Group, The Royal Bank of Scotland plc and National Westminster Bank Plc Boards in discharging their responsibilities and in making all relevant disclosures in relation to the financial affairs of the Group;
- review accounting and financial reporting and regulatory compliance;
- review the Group's systems of internal control; and
- monitor the Group's processes for internal audit and external audit.

The terms of reference of the Audit Committee are available at www.rbs.com and these are considered annually by the Audit Committee and approved by the Board.

The Audit Committee is satisfied that it has complied with the relevant provisions of the Code and the new Code.

Audit Committee Chairman
As Chairman of the Audit Committee, I play a leading role in the setting of the annual agenda planner for the Committee and with the agenda for each Committee meeting. Prior to every Committee meeting, I hold meetings with each of the Head of Group Internal Audit, the external auditors, the Group Finance Director and the Group Chief

Accountant. These meetings are instrumental in ensuring that I am briefed on all relevant issues and that these are brought to the attention of the Audit Committee.

Meetings and visits

A total of seven meetings of the Audit Committee were held in 2010, including meetings held immediately prior to the submission of the interim and annual financial statements to the Boards and the quarterly Interim Management Statements. Audit Committee meetings are attended by relevant executive directors, the internal and external auditors and Finance and Risk management executives. Other executives, subject matter experts and external advisers are also invited to attend the Audit Committee, as required, to present and advise on reports commissioned by the Committee. At least twice per annum the Audit Committee meets privately with the external auditors.

The Audit Committee's annual programme of visits to the Group's business divisions and control functions continued in 2010, and these are now also attended by the Board Risk Committee. The object of the programme is to allow the Audit Committee and the Board Risk Committee to gain a better understanding of the Group and an invitation to attend is extended to all non-executive directors. The programme of future visits is considered annually. The Audit Committee and the Board Risk Committee undertook six visits in 2010. These were to the Global Banking & Markets business; the Non-Core Division, Global Restructuring Group and the Asset Protection Scheme; Major Change Projects ongoing in the Group; the US Asset-backed Securities business; Risk Management and the Global Banking & Markets, Global Transaction Services and Private Banking businesses in Asia.

Work in 2010
During 2010, the work of the Audit Committee focused on a number of key areas, including:

- accounting, financial reporting and regulatory compliance;
- impairments and fair values;
- standards of internal control, including the work of the internal and external auditors;
- provisioning and credit exposures;
- general insurance reserves; and
- the work and role of Divisional Risk and Audit Committees in so far as they relate to the work of the Committee.

The Audit Committee received regular updates on accounting issues and developments from both the Group Chief Accountant and from the external auditors, who presented for approval to the Committee their audit plan, their audit fee proposal and engagement letter, as well as confirmation of their independence and a comprehensive report of all non-audit fees.

In addition the external auditors provided the Audit Committee with reports summarising their main observations and conclusions arising from their year end audit, their half year review and their work in connection with the first and third quarters, inter alia, inclusive of their comments on the issues set out below; and their recommendations for enhancements to the Group’s reporting and controls.

The Audit Committee focused on a number of salient judgments and reporting issues in the preparation of the 2010 accounts, including:

- valuation methodologies and assumptions for financial instruments carried at fair value including the Group's credit market exposures and the disclosures provided;
- actuarial assumptions for the Group Pension Fund;
- impairment losses in the Group's portfolio of loans and advances and available-for-sale securities;
- impairment of goodwill and other purchased intangible assets;
- the Group’s tax position, including the treatment of deferred tax assets; and
- compliance with the requirements of the Sarbanes-Oxley Act 2002.

In its consideration of each of these issues, the aims of the Audit Committee have been to:

- understand and challenge the valuation and other accounting judgments made by management;
- review the conclusions of the external auditors and, where applicable, other experts and to understand how they came to their conclusions; and

- satisfy itself that the disclosures in the financial statements about these estimates and valuations are transparent and appropriate.

The Audit Committee was regularly advised of whistleblowing events which occurred within the Group; of complaints raised with members of the Group's executive team; of significant internal investigations undertaken within the Group; and of internal regulatory reviews and investigations.

Group Internal Audit's role is to continuously assess how operating risks are being managed and controlled throughout the Group and report regularly to the Group Executive and Audit Committee on the results of these assessments; and to influence the continuous development of the risk management and control process through sharing best practice.

The Audit Committee oversees the work of Group Internal Audit, and receives a quarterly report from the Head of Group Internal Audit. This report rates the quality of the control environment of all the Group's divisions and of management's level of awareness on these matters. Group Internal Audit report to the Committee on areas where improvements are required to the control environment. The Audit Committee actively monitors these reports and ensures relevant matters raised are dealt with in a timely and appropriate manner. These reports offer the Audit Committee oversight of Group Internal Audit's work, and allow the Audit Committee to monitor the level of internal control within the Group.

The Audit Committee oversees the Group's compliance with the rules of the APS, and reviews regular progress reports from RBS Risk Management.

Relevant management also presented on a number of specific reporting, compliance and internal control matters.

As far as it can determine, the Audit Committee received all the information and material it required to allow it to meet its obligations in respect of the 2010 financial statements.

External auditors
Deloitte LLP has been the company’s auditors since March 2000.

The Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the external auditors and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The annual evaluation is carried out following completion of the annual accounts and audit.

In assessing the effectiveness of the Group’s external auditors the Audit Committee has regard to:

- the experience and expertise of the senior members of the engagement team;
- the proposed scope of the audit work planned and executed;
- the quality of the dialogue between the external auditors, the Committee and senior management;
- the clarity, quality and robustness of written reports presented to the Committee setting out the external auditor’s findings arising from the audit;
- the quality of the observations provided to the company by the external auditor on the Group’s systems of internal control; and
- the views of management on the performance of the external auditors.

The outcomes of the evaluation were considered by the Audit Committee and Board.

In addition to the annual evaluation performed by the Audit Committee, the external auditors conduct their own annual review of audit quality.

Twelve service criteria for the audit have been defined by the external auditors to measure their performance against the quality commitments set out in their annual audit plan, under the headings of “quality of audit approach and conduct”, “independence and objectivity”, “quality of the team” and “value added”. A questionnaire is completed by each Divisional CFO and each Divisional Risk and Audit Committee chairman after the completion of the annual audit and by relevant members of Group management and the Audit Committee. A follow up interview is held with each of them by senior partners independent of their immediate service teams. The results of this exercise will be presented to the Audit Committee, with actions defined and agreed to address any areas where performance has fallen below expected standards.

The external auditors are required to rotate the lead audit partner responsible for the audit every five years and, in 2010, a new audit partner was appointed to lead the audit for the year ending 31 December 2010. There are no contractual obligations restricting the company's choice of external auditor.

The Audit Committee is responsible for making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors. In order to make a recommendation to the Board, the Audit Committee consider and discuss the performance of the external auditor in the previous year, taking account of the outcomes of the annual evaluation carried out. The Board submits the Audit Committee's recommendations to shareholders for their approval at the Annual General Meeting. The Board has endorsed the Audit Committee's recommendation that shareholders be requested to approve the reappointment of Deloitte LLP as external auditors at the Annual General Meeting in April 2011.

The Audit Committee approves the terms of engagement of the external auditors. The Audit Committee also fixes the remuneration of the external auditors as authorised by shareholders at the Annual General Meeting.

Audit and non-audit services

The Audit Committee has adopted a policy on the engagement of the external auditors to supply audit and non-audit services, which takes into account relevant legislation regarding the provision of such services by an external audit firm.

In particular, the Group may not engage the external auditors to provide any of the non-audit services described below:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions or contribution-in-kind reports;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit; or
- other services determined to be impermissible by the US Public Company Accounting Oversight Board.

The Audit Committee reviews the policy annually and prospectively approves the provision of audit services and certain non-audit services by the external auditors.

Annual audit services include all services detailed in the annual engagement letter including the annual audit and interim reviews (including US reporting requirements) and periodic profit verifications.

Annual audit services also include statutory or non-statutory audits required by any Group companies that are not incorporated in the UK. Terms of engagement for these audits are agreed separately with management, and are consistent with those set out in the audit engagement letter insofar as local regulations permit.

Prospectively approved non-audit services include the following classes of service:

- capital raising, including consents, comfort letters and relevant reviews of registration statements;
- provision of accounting opinions relating to the financial statements of the Group;
- provision of reports that, according to law or regulation, must be rendered by the external auditors;
- tax compliance services;
- permissible services relating to companies that will remain outside the Group;
- restructuring services relating to the Group's customers; and
- reports providing assurance to third parties over certain of the Group's internal controls prepared under US Statement of Auditing Standards 70 or similar auditing standards in other jurisdictions.

For all other permitted non-audit services, Audit Committee approval must be sought, on a case by case basis, before the provision of the service commences. In August 2010, the Audit Committee approved changes to the existing non-audit services policy. The new streamlined process allows for the Chairman of the Audit Committee (or, in his absence, a designated delegate) to approve any non-audit services request with a value under £100,000. Any request with a value above this amount must be approved by the full Audit Committee. To ensure good governance all requests, regardless of financial limits, have to be approved by the Group Chief Accountant and Group Sourcing and Vendor Management. At each Audit Committee meeting, any non-audit services requests which have been approved since the previous meeting are considered for ratification.

In addition, the Audit Committee reviews and monitors the independence and objectivity of the external auditors when it approves non-audit work to be carried out by them, taking into consideration relevant legislation, ethical guidance and the level of non-audit services relative to audit services. The approval process is rigorously applied to prevent the auditors from functioning in the role of management, auditing their own work, or serving in an advocacy role. Information on the audit and non-audit services carried out by the external auditors is detailed in Note 5 to the Group's accounts.

Performance evaluation

An external review of the effectiveness of the Audit Committee takes place every three to five years, with internal reviews by the Board continuing in the intervening years. An internal review of the effectiveness of the Audit Committee during 2010 was conducted. The evaluation used detailed questionnaires and individual meetings were held with each member. Amongst the areas reviewed were the role of the Committee, composition, meetings and processes, performance and reporting, policy and procedures, divisional committees, induction and continuing professional development and communication.

The evaluation concluded that the Audit Committee operated effectively throughout 2010. The Committee was seen as effective in meeting its objectives, with members willing to spend the time necessary to do a good job. It was agreed that the new Chairman was a strong addition to the Committee, in particular given his strong financial background. The evaluation concluded that, whilst the Committee was of the appropriate size to discharge its responsibilities and the members had the appropriate skills and experience, Committee composition should be kept under review to ensure that the correct balance of skills and experience is maintained. The training and specific sessions on individual businesses and divisions were highly rated.

The Committee has considered and discussed the report on the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted, the conclusions and the recommendations for action. The outcomes of the evaluation have been reported to the Board and the actions are being progressed.

An external review of the effectiveness of Group Internal Audit takes place every three to five years, in line with best practice, with internal reviews continuing in the intervening years. In 2010, an external review was conducted by Ernst & Young. In May 2010, the Audit Committee was presented with the final report by Ernst & Young. The report found that Group Internal Audit was compliant with all relevant professional standards.

In January 2011 the Audit Committee undertook an internal evaluation of Group Internal Audit. The Committee sought views from members and attendees of the Committee, the external auditor, Divisional Chief Executive Officers and Finance Directors, Divisional Risk and Audit Committee and subsidiary audit committee Chairmen. The evaluation concluded that Group Internal Audit had operated effectively throughout 2010.

Divisional Risk and Audit Committees

Since 2005, Divisional Audit Committees have been responsible for reviewing each division's business. Following the creation of the Board Risk Committee in January 2010, the Group’s Divisional Audit Committees became Divisional Risk and Audit Committees and their terms of reference were revised to ensure full alignment with the Audit Committee and Board Risk Committee. With input from the Audit Committee, Board Risk Committee, Group Finance and Group Risk, a new framework was approved by the Audit Committee and Board Risk Committee in December 2010 and implemented in January 2011.

Brendan Nelson
Chairman of the Audit Committee
23 February 2011

Internal control

Management of The Royal Bank of Scotland Group ("the Group") is responsible for the Group's system of internal control that is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, the Group has regard to the nature and extent of the risk, the likelihood of it crystallising and the cost of controls. A system of internal control is designed to manage, but not eliminate, the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against the risk of material misstatement, fraud or losses.

Management's Report on Internal Control over Financial Reporting

Management of the Group is responsible for establishing and maintaining adequate internal control over financial reporting for the Group.

The Group's internal control over financial reporting is a component of an overall system of internal control. The Group's internal control over financial reporting is a process designed to provide reasonable assurance regarding the preparation, reliability and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS") and it includes:

- Policies and procedures that relate to the maintenance of records that, in reasonable detail, fairly and accurately reflect the transactions and disposition of assets.

- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management.

- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with policies or procedures may deteriorate.

Management assessed the effectiveness of the Group's internal control over financial reporting as of 31 December 2010 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in "Internal Control - Integrated Framework".

Based on its assessment, management believes that, as of 31 December 2010, the Group's internal control over financial reporting is effective.

The effectiveness of the Group's internal control over financial reporting as of 31 December 2010 has been audited by Deloitte LLP, the Group's independent registered public accounting firm. The report of the independent registered public accounting firm to the directors of the Royal Bank of Scotland Group plc expresses an unqualified opinion on the effectiveness of the Group's internal control over financial reporting as of 31 December 2010.

Disclosure controls and procedures

As required by US regulations, the effectiveness of the company's disclosure controls and procedures (as defined in the rules under the US Securities Exchange Act of 1934) have been evaluated. This evaluation has been considered and approved by the Board which has instructed the Group Chief Executive and the Group Finance Director to certify that, as at 31 December 2009, the company's disclosure controls and procedures were adequate and effective and designed to ensure that material information relating to the company and its consolidated subsidiaries would be made known to them by others within those entities.

Changes in internal control

There was no change in the company's internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc

We have audited the internal control over financial reporting of The Royal Bank of Scotland Group plc and subsidiaries (''the Group") as of 31 December 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Group's management is responsible for maintaining effective internal control over financial reporting and for assessing its effectiveness as described in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk of whether a material weakness existed, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of 31 December 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as at and for the year ended 31 December 2010 of the Group and our report dated 23 February 2011 (31 March 2011 as to the consolidating financial information included in Note 45 of the financial statements) expressed an unqualified opinion on those financial statements.

/s/ Deloitte LLP
London, United Kingdom
23 February 2011

Board Risk Committee Report by Philip Scott, Chairman

Membership

I have been Chairman of the Board Risk Committee since its formation in January 2010, and I am a member of the Committee along with Colin Buchan, Sandy Crombie, Brendan Nelson and Joe MacHale. We all served throughout 2010 with the exception of Brendan Nelson who became a member of the Committee with effect from 1 April 2010. All members of the Board Risk Committee are independent non-executive directors. Attendance of each member at meetings of the Board Risk Committee in 2010 is shown on page 178.

Archie Hunter was a member of the Board Risk Committee until 28 April 2010 when he stood down as a non-executive director at the end of his existing term.

Colin Buchan, Brendan Nelson and I are also members of the Audit Committee. This common membership ensures effective governance across all Finance and Risk issues, and that agendas are aligned and overlap is avoided. The Board Risk Committee and Audit Committee also have strong links with the Remuneration Committee, with particular regard to ensuring that relevant Finance and Risk matters are factored in to the determination of appropriate levels of compensation.

The Board Risk Committee is responsible for:

- providing oversight and advice to the Group, The Royal Bank of Scotland plc and National Westminster Bank Plc Boards (the "Boards") in relation to current and potential future risk exposures of the Group and risk strategy, including determination of risk appetite and tolerance;
- reviewing the performance of the Group relative to risk appetite;
- assisting on such other matters as may be referred to it by the Boards;
- oversight of the effectiveness of key Group policies, referred to as the Group Policy Framework;
- promoting a risk awareness culture within the Group; and
- reporting to the Group Board, identifying any matters within its remit in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

The terms of reference of the Board Risk Committee are available at www.rbs.com and these are considered annually by the Board Risk Committee and approved by the Board.

Qualitative and quantitative information regarding the risks arising from the Group's financial instruments required under International Financial Reporting Standard 7 are incorporated within the financial statements and Business review.

Meetings and visits

A total of nine meetings of the Board Risk Committee were held during 2010. Meetings are held as soon as practicable prior to Audit Committee meetings to ensure that the work of the two Committees is coordinated and consistent. A meeting is held immediately prior to submission of the interim and annual financial statements to the Board and the quarterly Interim Management Statements. This core programme is supplemented by additional meetings as required. Board Risk Committee meetings are attended by relevant executive directors, risk management, finance executives and the internal auditors. External advice may be sought by the Board Risk Committee where considered appropriate.

The Board Risk Committee took part in an annual programme of visits to the Group's business divisions and control functions in 2010, along with the Audit Committee. The object of the programme is to allow the Board Risk Committee and the Audit Committee to gain a better understanding of the Group and an invitation to attend is extended to all non-executive directors. The programme of future visits is considered annually. The Board Risk Committee and the Audit Committee undertook six visits in 2010. These were to the Global Banking & Markets business; the Non-Core Division, Global Restructuring Group and the Asset Protection Scheme; Major Change Projects ongoing in the Group; the US Asset-backed Securities business; Risk Management and the Global Banking & Markets, Global Transaction Services and Private Banking businesses in Asia.

Work in 2010
During 2010, the work of the Board Risk Committee focused on a wide range of matters, including the following key areas:

- risk strategy and policy;
- risk profile;
- risk appetite, framework and limits;
- risk management operating model; and
- remuneration.

At each meeting of the Board Risk Committee, the Group Chief Risk Officer provided the Committee with a presentation on the key risk issues faced by the Group. An update was also given on the key issues discussed at the Group's Executive Risk Forum. In 2010 the Board Risk Committee considered a range of matters including:

- the Group's economic capital model;
- the structured credit portfolio;
- the output of stress testing and scenario planning;
- the operational plan for the Group's risk management function including organisation, resource and budget;
- treating customers fairly and customer complaints; and
- remuneration strategy and policy, including recommendations to the Remuneration Committee.

The Board Risk Committee played a key oversight role in the review, design and implementation of risk management and measurement strategies and risk management policy across the Group.

The Board Risk Committee considered the Group's risk profile relative to current and future Group strategy. The Committee reported to the Board following each meeting on its consideration of the risk profile of the Group and any longer term macro or perceived strategic threats to the Group and made recommendations as appropriate.

The Group Policy Framework provides a basis for ongoing self-assessment of appropriate risk appetite. The Board Risk Committee received regular reports on the development of the Group Policy Framework during 2010.

The Group risk appetite framework was developed significantly during 2010 and continues to be enhanced. Risk appetite was regularly reviewed by the Board Risk Committee, which makes recommendations to the Board on risk appetite and tolerance as part of this ongoing process. This includes the Risk Management Operating Model, including the frameworks for credit, operational, regulatory, market, insurance and business continuity risk.

The Committee also considered the Group's exposure to country, single name and sector concentration risk and ensured rigorous stress and scenario testing of the Group's business was undertaken. The output of this testing was reviewed by the Board Risk Committee throughout 2010 with a view to ensuring appropriate actions were taken where necessary. It made recommendations to the Group Board regarding related authorities, limits and mandates.

In February 2010, the Committee was presented with and approved the RBS Risk Management operational plan, considering the adequacy and effectiveness of resource and the scope and nature of the work undertaken by the function.

The Committee considered the adequacy and effectiveness of the technology infrastructure supporting the finance and risk management framework.

The Committee reviewed the risk input to divisional bonus pools and provided advice to the Remuneration Committee on risk weightings to be applied to performance objectives which are incorporated within the incentive structure for the Group's senior executives. The Committee also reviewed clawback proposals made by Group Human Resources and made recommendations to the Remuneration Committee in this respect.

As required under the Walker Review, the Committee will meet as required to review the due diligence of any proposed strategic transaction (involving a merger, acquisition or disposal) prior to the Group Board approval of the transaction.

Performance evaluation

An internal review of the effectiveness of the Board Risk Committee during 2010 was conducted. The evaluation used detailed questionnaires and individual meetings were held with each member. Amongst the areas reviewed were the Role of the Committee, Composition, Meetings and Processes, Performance and Reporting, Policy and Procedures, Divisional Committees, Induction and Continuing Professional Development and Communication.

The evaluation concluded that the Board Risk Committee operated effectively throughout 2010. The Committee was seen as effective in meeting its objectives, although it was acknowledged that this was a relatively new Committee having only been formed in January 2010. The evaluation concluded that the commitment of its members was outstanding, with members willing to spend the time necessary to discharge the Committee's responsibilities. As a new Committee, the structure, content and length of Committee meetings was considered to be appropriate. It was acknowledged that the Committee makes the best use of skills, experience and competencies of its members and a high level of technical expertise was required of members.

The Committee considered and discussed the report on the outcomes of the evaluation and is satisfied with the way in which the evaluation was conducted, the conclusions and the recommendations for action. The outcomes of the evaluation have been reported to the Board and the actions are being progressed.

Divisional Risk and Audit Committees

Since 2005, Divisional Audit Committees have been responsible for reviewing each division's business. Following the creation of the Board Risk Committee in January 2010, the Group’s Divisional Audit Committees became Divisional Risk and Audit Committees and their terms of reference were revised to ensure full alignment with the Audit Committee and Board Risk Committee. With input from the Audit Committee, Board Risk Committee, Group Finance and Group Risk, a new framework was approved by the Audit Committee and Board Risk Committee in December 2010 and implemented in January 2011.

Philip Scott
Chairman of the Board Risk Committee
23 February 2011

Dear Shareholder,

I am pleased to be presenting the Group's Remuneration Report for 2010.

During the year, the Remuneration Committee has built on the progress made during 2009 when significant changes were made to the structure of rewards to staff following a thorough review of remuneration policy. We have continued to embed these practices throughout the organisation to ensure that they are aligned with good corporate governance and robust risk management.

Our focus is to ensure that our remuneration policy continues to support delivery of the Group's Strategic Plan. We are working hard to complete a hugely challenging and complex turnaround and are on track to deliver across a range of measures. The Group plays an important economic role, both as an employer and a lender. If we are going to achieve our strategic objectives and deliver a return to our shareholders including the UK taxpayer, we need talented and motivated management and employees. This requires us to pay them fairly within the context of the markets in which they operate. In setting pay policy, we take account of our duties to shareholders and our strategic objectives and seek to ensure that shareholder interests are not damaged as a result of staff retention, recruitment or motivation issues. Our commitment is to reward success not failure, and we are also very conscious of the need to demonstrate restraint.

Across the Group we operate a range of incentive structures which are designed to reinforce messages about what employees are being asked to achieve, and deliver pay for performance. Our key objective in determining bonus awards is not to pay more than is warranted given business performance. In this context performance includes financial and non financial measures, risk performance and any other relevant factors. Our aggregate bonus awards for 2010 are lower than prior year as a result of lower profits and bonuses in the investment banking division and our recognition of the need for moderation. There is clear focus on differentiation, so that individually and by business, the best performers and the best performance will continue to be rewarded. There is strong central governance and oversight of both bonus pools and individual awards, and each year a significant proportion of staff will receive zero bonus.

The key elements of our remuneration policy are:

Pay for performance
Performance related pay is designed to reflect success or failure against the range of targets which we set for our people, taking into account the context in which results were achieved. By way of example, the pay arrangements for executive directors are aligned to the performance of the Group and performance related pay is paid entirely in shares over several years. Executive directors have "no reward for failure" provisions in their service contracts.

Performance management
We operate a structured process to ensure that all employees have clear objectives that are linked to long-term plans designed to drive business objectives including financial performance, risk, people and customer measures. Assessment of individuals' performance is subject to a rigorous review of achievements against their objectives.

Risk adjustment
Focus on risk is achieved through clear risk input into incentive plan design and target setting, as well as a thorough risk review of performance, bonus pools and clawback. The Remuneration Committee has been supported in this by the Board Risk Committee and the RBS Risk Management function.

Deferral

The Remuneration Committee is acutely aware of the external focus on the role of incentive payments in the financial sector. The reality is that these remain a key part of the structure of pay across the industry. However, we have radically reformed our incentive plans. For our more senior employees annual awards are deferred over three years and a portion of the awards are paid in shares which increases alignment with the interests of shareholders. There will be a £2,000 cap on cash bonuses paid in March 2011, as was the case last year.

Clawback

We have had clawback provisions in place since 2009, which means that, in certain circumstances, the Group can reduce deferred annual incentives and long-term incentive awards up to the point they are released. Clawback allows us to respond appropriately if the performance factors on which reward decisions were based turn out not to reflect the corresponding performance in the longer term.

Shareholder consultation

In early 2011, we consulted extensively with institutional shareholders and other stakeholders on our remuneration approach. The consultation process involved one to one meetings and a roundtable session hosted by the Association of British Insurers and National Association of Pension Funds. Our presentation covered our wider remuneration policy as well as executive directors' remuneration and we have been pleased with both the level of engagement with investors and the positive feedback we have received.

Topics discussed with investors included pay positioning, scale and design of incentive structures, risk alignment of remuneration, deferral, clawback and remuneration disclosures. We have listened to the feedback from investors and have made a number of enhancements to disclosures in the Remuneration Report as a result.

Investors recognised the difficult challenge faced by the Remuneration Committee in positioning pay competitively to support business goals, while being mindful of the wider economic environment and the need to show restraint. The Remuneration Committee and the Board have considered carefully their responsibilities and have applied judgement to achieve a balance whereby remuneration policy supports business goals without causing unacceptably high people risks.

The retention and motivation of our executive directors is crucial over the next three years and whilst most aspects of our remuneration policy remain unchanged, we are making some changes to enhance the overall effectiveness of executive director remuneration. These include replacing the annual incentive plan with a long-term Share Bank and changes to the performance measures for the Long Term Incentive Plan (LTIP). We have introduced a scorecard of measures relating to risk and strategic goals to sit alongside the existing measures of total shareholder return and economic profit. These measures ensure that rewards for executive directors are aligned with achieving a sustainable long-term platform for the future success of the Group across a range of areas including risk, profitability, franchise strength and people. Details of these changes are set out in the Remuneration Report.

While the primary focus of the remuneration policy clearly has to be to support the business to deliver the Strategic Plan, some shareholders asked for reassurance that the Remuneration Committee had in place sufficient tools to be able to adjust remuneration appropriately should another financial crisis occur. I am pleased to confirm that a huge amount of progress has been made in this respect.

The starting point is making sure we set the right objectives in the first place. Risk is a key factor when setting annual and long term objectives and an independent review of risk objectives is undertaken by the RBS Risk Management function and the Board Risk Committee. At the end of each performance period, performance outcomes and bonus pool proposals are subject to rigorous review by the control functions, independent of the businesses/divisions. Our LTIP also has a risk underpin whereby awards will not vest unless the Remuneration Committee is satisfied on risk performance. Both annual and long term awards are subject to clawback and, accordingly, the Remuneration Committee has discretion to reduce the number of shares under award or determine that no shares will vest.

Changes to approach
In addition to the changes made to executive directors' remuneration arrangements, the Remuneration Committee reached decisions on the following key areas during 2010:

- establishing a governance framework for incentive plans and bonus funding across the Group, involving the Finance, Risk and Human Resources functions at all key decision points;
- a structure of deferment for incentives for up to three years, with the ability to clawback if appropriate; and
- the introduction of a new Long Term Incentive Plan following consultation with a number of institutional shareholders.

The new LTIP received the approval of over 99% of shareholders at the Annual General Meeting in 2010, and at the same meeting the Remuneration Report received overwhelming shareholder support.

External developments
A number of external developments have impacted remuneration and remuneration policy in 2010, including the publication of the FSA's revised Remuneration Code (the "FSA Code"). In light of the FSA Code, a review was undertaken of the remuneration policy and governance arrangements. I am pleased to report that the Group has been fully compliant with all aspects of the FSA Code from 1 January 2011.

The Remuneration Committee supports the UK Government's position that an international approach is required in relation to regulation on remuneration and disclosure. To rebuild the value of the company, an international level playing field that allows the Group and other UK banks to compete fairly with international competitors is essential.

On 9 February 2011, the UK Government issued a statement in connection with Project Merlin, which represents commitments by the UK's four largest banks, including the RBS Group, on matters including lending, shareholder engagement and pay disclosures. The banks have agreed that aggregate UK bonus pools will be lower than last year reflecting consideration of the public mood and engagement with key stakeholders. Furthermore, as a result of the Project Merlin agreement, we are disclosing in this year's Remuneration Report the pay of our two executive directors and the pay of the five highest paid senior executive officers. The Remuneration Committee has also reviewed the remuneration of the ten highest paid staff in each of the Group's divisions.

Throughout 2010 we continued to work through a period of unprecedented restructuring. The Group has delivered remuneration arrangements that are FSA compliant, take proper account of the public mood and call for restraint and support the overarching objective of maximising shareholder returns and delivering a profit for the taxpayer. Importantly, these arrangements are consistent with the Project Merlin agreement.

On behalf of the Remuneration Committee I would like to place on record our sincere appreciation for our people who have continued to focus on service to our customers, managing risk and driving the performance of our core and non-core businesses. Our people are working hard to help return the Group to financial strength and the Remuneration Committee is committed to creating an environment in which they can meet their ambitions.

Penny Hughes
Chair of the Remuneration Committee
23 February 2011

Membership of the Remuneration Committee

The current members of the Remuneration Committee are Penny Hughes (Chair since 1 June 2010), Sandy Crombie, and John McFarlane. The members of the Remuneration Committee are all independent non-executive directors. Colin Buchan stepped down as Chairman and member of the Remuneration Committee on 1 June 2010. Attendance of each member at meetings of the Remuneration Committee in 2010 is shown on page 178.

Responsibilities

The Remuneration Committee is responsible for setting the Group's policy on remuneration and overseeing its implementation, considering executive remuneration and making recommendations to the Group Board in respect of the remuneration arrangements of the executive directors of the Group. No director is included in decisions regarding his or her own remuneration.

The Remuneration Committee is also responsible for setting the remuneration arrangements for members of the Group's Executive Committee and Management Committee, as well as all higher-earning employees and any employees falling within the definition of "Code Staff" under the FSA Code. Details of the FSA Code can be found at www.fsa.gov.uk.

The Remuneration Committee undertakes a regular review of the adequacy and effectiveness of the remuneration policy to ensure it is fully aligned with the Group's long-term objectives. The Committee receives a number of reports to assist it in its oversight of remuneration policy, such as on risk and financial performance across the Group.

In determining directors' remuneration, the Remuneration Committee has taken into account pay and employment conditions of employees of the company. It does this using an analysis of annual market data against an assessment of the competitiveness of current base salary ranges or benchmarks and actual salaries in payment. Salary increases for executive directors are also considered in the context of salary increases for the wider employee population.

The Remuneration Committee considers remuneration in the context of the wider Group agenda such as talent development and the external market environment. The Remuneration Committee recognises that remuneration is only one aspect of the value proposition which the Group presents to our employees, and that engagement, flexibility and career development are important factors. It has received in-depth presentations from Human Resources functions in the USA and Asia so as to have a better understanding of the unique issues in these areas. Penny Hughes has also attended a number of external meetings and workshops with organisations such as Women in Business and the Young Bankers' Association to gain a broader understanding of the people agenda.

The Remuneration Committee also receives regular updates on regulatory developments and general remuneration issues, as well as market and benchmarking data from its remuneration advisors to support its decisions.

In December 2010, the Asset Protection Scheme Performance and Reward Committee (APSPRC) was formed. It is responsible for reviewing, reporting and, in certain cases, making recommendations to the Remuneration Committee in respect of (i) collective overall and individual performance of individuals who manage business units or assets which are assigned to or participate in the Asset Protection Scheme (APS), and members of the Group executive against the APS performance targets; ("APS In-Scope employees") (ii) the individual proportion of the incentive and bonus components of the remuneration of those employees to be evaluated against APS performance targets for each calendar year and (iii) whether clawback should be applied to any deferred compensation elements of the remuneration of those employees prior to their vesting.

The Remuneration Committee considers recommendations and reviews reports from the APSPRC and is responsible for determining the remuneration of APS In-Scope employees.

Remuneration advisors

On 14 September 2010, the Remuneration Committee appointed PricewaterhouseCoopers LLP ("PwC") as its remuneration advisors, replacing Towers Watson. PwC were appointed after a formal selection process of panel interviews following the submission of detailed written proposals by a number of remuneration advisors. One aspect taken into account as part of the selection process was that the remuneration advisors be signatories to the voluntary code of conduct in relation to executive remuneration consulting in the UK. Both PwC and Towers Watson are signatories to the code of conduct and the relationship between the Remuneration Committee and both companies takes account of this.

During the year, as well as advice received from Towers Watson and PwC, the Committee took account of the views of the Group Chairman, Philip Hampton; Group Chief Executive, Stephen Hester; Group Human Resources Directors, Neil Roden (until October 2010) and Elaine Arden (from October 2010); the Group General Counsel and Group Secretary, Miller McLean (until April 2010); and the Group Secretary, Aileen Taylor (from May 2010). Advice was received from Nathan Bostock, Head of Restructuring and Risk, on risk-adjustment of measures for bonus pool funding and a risk review of individual performance evaluations for the Management Committee. The Chairman of the Board Risk Committee, Philip Scott, also attended a Remuneration Committee meeting to advise the Committee on matters relating to risk adjustment.

PwC also provides professional services in the ordinary course of business including assurance, advisory, tax and legal to subsidiaries of the Group. Towers Watson also provides actuarial advice to subsidiaries of the Group and investment consulting and actuarial advice to the trustees of some of the Group's pension funds. The advisors to the Remuneration Committee are appointed independently by the Committee, which reviews its selection of advisers annually. The Committee is notified of any work that is being undertaken by its advisors and is satisfied that there are processes in place to ensure that the advice it receives is independent.

Performance evaluation

An internal review of the effectiveness of the Remuneration Committee during 2010 was conducted. The evaluation used detailed questionnaires and individual meetings were held with each member. Amongst the areas reviewed were the role of the Committee, composition, meetings and processes, continuing professional development and communication.

Generally, the Committee was considered to be effective and meeting its objectives, with members willing to spend the time necessary to discharge their responsibilities. Whilst the Committee was viewed as being of the right size and headed by a strong Chair, composition will be kept under review to maintain the correct balance of skills and experience. Improvement in the quality of Committee papers was acknowledged, although work is being undertaken to deliver further improvements. The importance of a strong link between the Committee and the Board Risk Committee was recognised and, whilst it was acknowledged that this relationship was working well, it was agreed that further improvements should be actively considered.

The Committee has considered and discussed the report on the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted, the conclusions and the recommendations for actions. The outcomes of the evaluation have been reported to the Board and the actions are being progressed.

Group-wide remuneration policy

The Remuneration Committee has reviewed the Group's remuneration policy which is anticipated will apply in 2011 and in subsequent years.

The remuneration policy supports the Group's business strategy and is designed to:

- attract, retain, motivate and reward high calibre employees to deliver superior long-term business performance; and
- ensure that the Group's metrics, reward structures and governance processes as a whole provide coverage of the key risks in an appropriate way.

The key principles underpinning the remuneration policy are set out below:

Pay-for-performance

Reward is linked to business and individual performance and appropriate account is taken of risk factors associated with that business, including where appropriate risks associated with the sustainability agenda.

Market facing

Reward structures are designed to offer value for money in the markets where the Group operates. Both annual compensation and total compensation are set around market median competitiveness although our pay-for-performance policy allows for higher pay for the highest performers.

Allow for customisation

The composition of reward generally allows for customisation through individual choice, in order to maximise value delivered to employees.

Governance

There is a robust governance framework in place to ensure that reward design and delivery complies with appropriate policy, standards, and meets relevant regulatory requirements.

The Remuneration Committee undertakes an annual review of the adequacy and effectiveness of the remuneration policy to ensure it is fully aligned with the Group’s long-term objectives. There is also a key role for the RBS Risk Management function in the management and oversight of reward structures and decision-making. The Remuneration Committee will consider any issues raised by the Board Risk Committee prior to approving the policy.

The individual elements of employees' remuneration packages are as follows:

Base salary
Base salaries should be appropriate in the specific market for the business in which an individual works and also reflect the talents, skills and competencies that the individual brings to the Group. There should be a sufficient level of fixed pay so that inappropriate risk-taking is not encouraged.

Annual incentives
Annual incentives are designed to reward good financial and non-financial performance that supports the business strategy, taking into account the Group’s risk appetite and personal contribution in the context that it was delivered.

The approach to determining an appropriate annual incentive pool is based around four technical workstreams led by the central control functions (Finance, Human Resources and RBS Risk Management). The workstreams provide context around how much a market-competitive/on target pool would be on financial performance, on risk performance, on capital adequacy and on the impact of incentive awards on the balance sheet.

Performance is central to the determination of annual incentive pools. Performance assessment is based on a balanced scorecard of measures including financial performance, risk, people and customer measures.

Overall expenditure on annual incentives is reviewed by the Remuneration Committee at the end of each year taking into account the performance of the business on the basis described above. This is further scrutinised on a divisional and functional basis based on a range of different efficiency and risk adjusted profit measures including changes in Economic Profit for shareholders.

Allocation of any variable reward from the pool depends on divisional, functional and individual performance against the performance measures set at the beginning of the year. Individual performance assessment is supported by a structured performance management framework. Targets should be specific, measurable, set at the beginning of the year and communicated to the employees.

The Group only uses guaranteed bonuses in limited circumstances in accordance with the FSA Code.

Deferred awards

The purpose of deferred awards is to support a performance culture where employees recognise the importance of sustainable Group, business and individual performance. Under the Group-wide deferral arrangements a significant proportion of annual incentive awards for our more senior employees will be deferred over a three year period. Deferred awards are subject to clawback.

A new deferral plan was approved by shareholders on 15 December 2009. Under this plan, annual incentives are deferred into awards vesting over a three year period. A significant portion of deferral is in a form which meets regulatory requirements.

Long-Term Incentive Plans

To encourage the creation of value over the long term and to align the rewards of the participants with the returns to shareholders, the
Group provides employees in senior roles (executive level and selected senior management) the opportunity to receive annual awards of long-term incentives.

A new Long-Term Incentive Plan was approved by shareholders on 28 April 2010, under which awards are structured as performance-vesting shares. For the most senior roles, vesting will be based partly on divisional or functional performance and partly on performance across the Group.

Awards will not vest unless the Remuneration Committee is satisfied that risk management during the performance period has been effective at a Group and division/functional level. The Remuneration Committee's determination will be informed by input from the Group Chief Risk Officer and the Board Risk Committee. Specifically, prior to vesting, the Remuneration Committee will have regard to risk and compliance across the Group and divisions and make an assessment of future risks as appropriate.

All awards are subject to clawback.

Pension arrangements

The Group aims to provide competitive retirement benefits. Since October 2006, UK employees have been eligible for a cash allowance in lieu of pension provision and have had the facility to choose to have part of their remuneration in the form of contributions to The Royal Bank of Scotland Group Retirement Savings Plan. A little over one half of UK employees continue to participate in defined benefit pension arrangements.

Executive remuneration policy

Components of executive directors' remuneration

Salary

Base salaries of executive directors are reviewed annually. It has been agreed that the Group Chief Executive will receive no increase in base salary in 2011. The annual salary for the Group Finance Director will be increased from £725,000 to £750,000 with effect from 1 April 2011.

Benefits

Executive directors are eligible to receive various employee benefits or a cash equivalent from a flexible benefits account, on a similar basis to other employees.

Details of pension arrangements of directors are shown on page 203. Gordon Pell retired from the Group and the Board on 31 March 2010, shortly after his normal pension age of 60. Details of his pension are shown in this report. Following Gordon Pell's retirement, no current director is a member of the Group's defined benefit pension plans.

For all executive directors joining on or after 1 October 2006, pension provision is in the form of a pension allowance which may be used to participate in The Royal Bank of Scotland Group Retirement Savings Plan which is open to all employees, or to invest in alternative pension arrangements, or to take all or some of the allowance in cash. In addition, as employees, executive directors are eligible to participate in Sharesave and Buy As You Earn plans. These plans are not subject to performance conditions since they are operated on an all-employee basis. Executive directors also receive death-in-service cover.

In addition to salary and benefits, executive directors receive variable remuneration in the form of annual and long-term incentives.

Annual incentives

Following consultation with UKFI and other institutional shareholders, a Share Bank arrangement has been put in place for the executive directors’ annual incentive awards for 2010 and 2011. The Share Bank arrangement replaces the previous annual incentive arrangement and means that the executive directors will receive no cash bonus.

2010

The 2010 targets covered progress against the Strategic Plan, financial performance, risk efficiency and control measures as well as stakeholder and people management. Executive directors have a normal maximum incentive opportunity of 200% of salary (with an exceptional maximum of 250% of salary).

The Remuneration Committee has reviewed the annual incentive awards for the executive directors for 2010 performance, taking into account performance against targets set at the beginning of 2010. Performance was assessed across a broad range of quantitative and qualitative measures and was supported by a robust performance management framework including a formal half year review.

During 2010, performance has been strong and all the Group's main performance indicators are ahead of the Strategic Plan both in terms of timing and outcomes. There are, however, a small number of areas where the Group is not performing well ahead of the targets which have been set. Accordingly, the Remuneration Committee has recommended, and the Board (excluding executive directors) has agreed, that the Group Chief Executive and Group Finance Director should receive annual incentive awards of 170% and 186% of salary respectively.

For 2010 performance, the executive directors' annual incentive will be delivered entirely as an allocation into Share Bank. The allocated shares will vest in two equal tranches in March 2012 and 2013, and must then be held for a further six months. The Group Chief Executive has voluntarily agreed to a total holding period of twelve months after vesting. Clawback provisions will again apply prior to vesting of the shares.

2011

The maximum potential allocation of shares in respect of the 2011 financial year under Share Bank will be 6.0 million shares for the Group Chief Executive and 3.75 million shares for the Group Finance Director. These allocations were agreed, following consultation with shareholders at the beginning of 2011. The potential allocations represent normal maximum annual incentive levels for executive directors based on the share price prevailing at the start of the consultation period and will be assessed for final allocation in 2012 on that basis. Depending on share price movement during the performance period, the value of the final allocation could further increase or decrease.

Between 0% and 100% of the maximum potential allocation will be formally allocated into Share Bank in March 2012 based on 2011 performance across five performance categories: strategic direction; business delivery and financial performance; stakeholders (including delivery against UK government lending commitments); risk and control; and capability and development. Fixing the number of shares in this way avoids unintended consequences arising from share price volatility around award dates and provides a clear alignment with shareholder interests through the year.

The Remuneration Committee will determine the actual allocation to Share Bank by reference to the extent to which executive directors have met the performance targets. Shares allocated in respect of 2011 performance will vest in two equal tranches in March 2013 and 2014 respectively. Clawback provisions will apply to shares allocated to Share Bank for the period prior to their vesting.

Share awards made as part of Share Bank will be delivered under the rules of the Deferral Plan approved by shareholders in 2009.

An illustration of Share Bank for the 2011 performance year is set out below:

To comply with the FSA Code, shares will be subject to a holding period of six months after vesting.

Long-term incentives

The Group provides long-term incentives which are designed to link reward with the long-term success of the Group and recognise the responsibility participants have in driving its future success and delivering value for shareholders.

Performance conditions attaching to awards made to executive directors under the LTIP in 2010 are shown on page 200.

As in 2010, awards in 2011 will be granted under the LTIP, and will be entirely in the form of shares (rather than share options).

Awards to executive directors have a normal maximum limit of 400% of salary. Whilst the award policy for executive directors may be increased in exceptional circumstances, prior shareholder consultation would be undertaken.

Awards granted to executive directors in 2011 will be capped at 375% of agreed salary.

Performance criteria for awards granted to executive directors under the LTIP in 2011
Performance conditions for the 2011 LTIP awards have been chosen not only to align executive directors directly with outcomes for shareholders but also with those key actions required to deliver shareholder value over the long term and factor in the growing regulatory emphasis on risk-adjusted financial metrics. The four performance measurement areas set out below are equally weighted:

- Relative Total Shareholder Return (TSR) (25%);
- Core Bank Economic Profit (25%);
- Balance Sheet & Risk (25%); and
- Strategic Scorecard (25%).

The four performance conditions attached to the awards (see description of performance conditions on pages 193 to 195) will each have the ability to deliver a number of shares worth up to 100% of salary (based on agreed salary at date of grant and share price based on a five day average prior to grant); however, the number of shares that vest will be subject to an overall cap in value of 375% of salary (again, based on agreed salary and share price at the time the award was made).

There is an underpin to the performance conditions whereby awards will only vest if the Committee is satisfied that risk management during the performance period has been effective and that financial and non-financial performance has been satisfactory, in line with the Strategic Plan. In assessing this, the Committee will be advised independently by the Board Risk Committee.

Relative TSR (applying to 25% of overall 2011 LTIP award in total)
Relative TSR has been retained in the LTIP to provide a direct connection between the reward provided to executive directors and the relative performance delivered to our shareholders.

The relative TSR performance condition is identical to that applying for 2010 LTIP awards. The relative TSR measure compares the Group's performance over a three year performance period against a basket of banks from the UK and overseas, weighted towards those companies most similar to the Group.

The companies in the comparator group for 2011 awards are as follows:

Comparator companies		Weighting
1	Barclays	200%
2	Lloyds Banking Group	
3	Santander	150%
4	HSBC	
5	Standard Chartered	
6	Citigroup	100%
7	Deutsche Bank	
8	JP Morgan Chase	
9	Bank of America	50%
10	BBVA	
11	BNP Paribas	
12	Credit Agricole	
13	Credit Suisse Group	
14	National Australia Bank Limited	
15	Royal Bank of Canada	
16	Societe Generale	
17	The Toronto-Dominion Bank Group	
18	UBS	
19	Unicredito	
20	Wells Fargo & Company	

To receive any of the LTIP awards subject to this performance measure the Group's performance must be at least as good as the median of the comparator companies, with vesting as follows:

- 20% of the award will vest if the Group's TSR is at the median of the companies in the comparator group.
- 100% of the award will vest if the Group's TSR is at the upper quartile of the companies in the comparator group.

A pro-rata proportion of the award will vest in between these points.

Core bank Economic Profit (applying to 25% of overall 2011 LTIP award in total)
At the end of the performance period for these awards, the value of the Group will be determined by the Core bank's ability to generate enduring returns for shareholders. For this reason for the 2011 LTIP awards the Economic Profit measure is focused on the Core bank. The focus on Core bank Economic Profit ensures that performance reflects enduring earnings for the bank, while the Balance Sheet & Risk targets capture performance of Non-Core.

Economic Profit, being a risk-adjusted financial measure, is consistent with the FSA Code, and also provides a balance between measuring growth and the cost of capital employed in delivering that growth.

Core bank Economic Profit is defined as return attributable to shareholders less equity multiplied by the cost of equity:

- return attributable to shareholders is Core Operating Profit reported in the financial statements, excluding fair value of own debt and APS, taxed at a standard tax rate of 28%.
- equity is defined as tangible equity allocated to the Core businesses, with adjustments to strip out distorting impacts arising from fair value of own debt, available-for-sale reserves, cashflow hedging reserve, and APS.
- current cost of equity is 12%, which is subject to review at least annually.

Targets have been set so that maximum vesting under the awards is only achieved for performance ahead of the Group's refreshed Strategic Plan. 25% of this portion of the award will vest at threshold performance. Threshold vesting requires average return on tangible equity over the performance period at a reasonable margin above the cost of capital.

Due to the commercially sensitive nature of these targets details of the actual targets, and performance against these, will be disclosed retrospectively once the award vests.

Balance Sheet & Risk and Strategic Scorecard (applying to 50% of overall 2011 LTIP award in total)
For the 2011 awards, 25% of the overall award will vest based on achievement of Balance Sheet & Risk targets and 25% of the overall award will vest on achievement of Strategic Scorecard targets, over a three year period.

These measures have been chosen to complement the Core bank Economic Profit and Relative TSR measures in aligning the LTIP with the advancement of the strategic position and capability of the organisation and the building of a sustainable business. The 2011 measures will have a particular focus on risk reduction, the resolution of the Non-Core business and the building of a sustainable and responsible franchise for the Group.

To ensure that the Group is positioned to deliver sustainable value for shareholders beyond the initial turnaround timeframe, the balanced Strategic Scorecard rewards management for delivering a robust basis for future growth in terms of the strength of our franchise, efficiency, reputation, and the strength and engagement of our employees.

For the first of these awards, the Remuneration Committee will assess and judge performance against the measures set out below.

Performance measures	
Balance Sheet & Risk measures and targets	Non-Core assets Cumulative Non-Core loss Group Core Tier 1 Capital Wholesale funding Liquidity reserves Leverage ratio Loan to deposit ratio Risk Appetite Framework Funded assets Attributes driving credit rating

Strategic Scorecard measures and targets	UK Retail and Commercial franchise US Retail and Commercial franchise Investment Banking franchise Measures from Group’s customer dashboard Cost:income ratio in Core bank European Commission divestments Sustainability Relative Economic Profit Growth Progress in people issues Embed strategic thinking, balanced business evolution Majority of Group’s divisions to have met the ‘5 tests’ at heart of the Strategic Plan

Where possible, quantitative strategic measures will be used. However, it is also important to the Group to focus on qualitative measures which consider issues such as reputation, customer excellence, organisational capability and sustainability given these will support the long term goals of the business.

Targets for each measure will be set at the start of the performance period. Where applicable these will be aligned with the bank’s published Strategic Plan targets. At the end of the period each measure will be assessed against the target, and vesting will be based on the proportion of targets fully met (see below), qualified by Remuneration Committee discretion taking other relevant factors into account. Consideration will also be given to volume of lending over the performance period, subject to commercial viability.

To avoid unintended consequences, the scorecard will not be set in a formulaic manner, but will provide a framework for structured Remuneration Committee discretion, which will be supported by disclosure at the end of the performance period justifying the vesting decision arrived at. In addition, commentary will be provided on an annual basis in relation to progress against targets (where not commercially sensitive).

Vesting point		Indicative performance
Does not meet	0%	Over half of objectives not met
Partially meets	25%	Half of objectives met
Significantly meets	62.5%	Two-thirds of objectives met
Fully meets	100%	Objectives met or exceeded in all material respects

Qualified by Remuneration Committee discretion taking into account changes in circumstances over the performance period, the relative importance of the measures, the margin by which individual targets have been missed or exceeded, and any other relevant factors.

Risk underpin and clawback
The Remuneration Committee will also review financial and operational performance against the Strategic Plan and risk performance prior to agreeing vesting of awards.

If the Remuneration Committee considers that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect the Group's underlying financial results or if the Committee considers that the financial results have been achieved with excessive risk, then the terms of the awards allow for an underpin to be used to reduce vesting of an award, or to allow the award to lapse in its entirety.

All awards are subject to clawback.

2011 compensation framework
The chart below summarises the 2011 compensation framework (illustration for the Group Chief Executive):

In order to comply with the FSA Code, shares will be subject to a holding period of six months after vesting.

Shareholding guidelines

The Group operates shareholding guidelines for executive directors. The target shareholding level is 200% of gross annual salary for the Group Chief Executive and 100% of gross annual salary for executive directors. Executive directors have a period of five years in which to build up their shareholdings to meet the guideline levels.

UK-based executive directors' remuneration balance

Executive director pay mix

Group Chief Executive - Stephen Hester

Group Finance Director - Bruce Van Saun

The charts above show the composition of remuneration opportunity for on-target annual performance, and with the long term incentive awards shown at the expected value. Short term incentive payments earned in relation to 2011 performance will be deferred and will vest, subject to satisfactory performance. The actual value of the long term incentive awards will depend on performance over the period 2011 to 2013 and the share price at the time the awards vest.

Non-executive directors

The level of remuneration for non-executive directors reflects their responsibility and time commitment and the level of fees paid to non-executive directors of comparable major UK companies. Non-executive directors do not participate in any incentive or performance plan. Non-executive director fees are reviewed regularly. Fees paid to non-executive directors for the year ended 31 December 2010 are set out on page 199.

Total shareholder return performance

The performance graph below illustrates the performance of the company over the past five years in terms of total shareholder return compared with that of the companies comprising the FTSE 100 Index. This Index has been selected because it represents a cross-section of leading UK companies. The total shareholder return for FTSE banks for the same period has been added for comparison. The total shareholder return for the company and the indices have been rebased to 100 for 2005. The second graph below illustrates the same performance of the company during 2010.

Total shareholder return

Total shareholder return - one year

Service contracts

The company's policy in relation to the duration of contracts with directors is that executive directors' contracts generally continue until termination by either party, subject to the required notice, or until retirement. The notice period under the service contracts of executive directors will not normally exceed twelve months. In relation to newly recruited executive directors, subject to the prior approval of the Remuneration Committee, the notice period may be extended beyond twelve months if there is a clear case for this. Where a longer period of notice is initially approved on appointment, it will normally be structured such that it will automatically reduce to twelve months in due course.

All new service contracts for executive directors are subject to approval by the Remuneration Committee. Those contracts normally include standard clauses covering the performance review process, the company's normal disciplinary procedure, and terms for dismissal in the event of failure to perform or in situations involving actions in breach of the Group's policies and standards.

Any compensation payment made in connection with the departure of an executive director will be subject to approval by the Remuneration Committee, having regard to the terms of the service contract and the reasons for termination.

No compensation was paid to Gordon Pell on his retirement from employment of the Group on 31 March 2010. Details of his pension are shown on page 203.

Information regarding directors' service contracts is shown below:

	Date of current contract	Notice period – from the company	Notice period – from executive
Executive directors			
Stephen Hester	4 November 2008	12 months	12 months
Bruce Van Saun	8 September 2009	12 months	12 months
Former executive director			
Gordon Pell	Contract expired	12 months	6 months

Except as noted below, in the event of severance where any contractual notice period is not worked, the employing company may pay a sum to the executive in lieu of the notice period. In the event of situations involving breach of the employing company's policies resulting in dismissal, reduced or no payments may be made to the executive. Depending on the circumstances of the termination of employment, the executive may be entitled, or the Remuneration Committee may allow, outstanding awards under long-term incentive arrangements to vest, subject to the rules of the relevant plan.

Stephen Hester

If Stephen Hester's employment is terminated by reason of his personal underperformance, the company is entitled to terminate by giving written notice with immediate effect and without making any payment in lieu thereof and Stephen Hester will forfeit any unvested stock awards.

In the event that Stephen Hester's employment is terminated by the company (other than by reason of his personal underperformance), the following will apply. First, he will be entitled to receive a payment in lieu of notice to the value of base salary, bonus and benefits (including pension contributions). Secondly, any share awards granted to him to replace bonus and share awards he forfeited on leaving The British Land Company PLC will vest immediately on such termination. If he resigns voluntarily and the company does not require him to work out his notice period, Stephen Hester may receive a payment in lieu of notice based on salary only (i.e. no bonus or benefits). In both cases the treatment of any other unvested stock awards will be determined at the discretion of the Remuneration Committee.

Bruce Van Saun

In the event that Bruce Van Saun's employment is terminated by reason of his personal underperformance, the company is entitled to terminate by giving written notice with immediate effect and without making any payment in lieu of notice. Any payment in lieu of notice that may be made to Bruce Van Saun would be based on salary only (i.e. no bonus or benefits).

The company has agreed that, provided certain conditions are met, on leaving employment, Bruce Van Saun will not forfeit awards under the rules of the Deferral Plan, the Medium-term Performance Plan and the Executive Share Option Plan.

Gordon Pell

Gordon Pell retired from employment of the Group on 31 March 2010 on attaining his normal retirement age. In line with the rules of the Group Pension Fund, no discount applied on payment of his pension.

Chairman and non-executive directors

Under the Articles of Association of the company, directors must stand for re-election by shareholders at least once every three years. However, in accordance with the provisions of the UK Corporate Governance Code, all directors of the company will stand for re-election by shareholders at the company's 2011 Annual General Meeting and annually thereafter. The original dates of appointment as directors of the company for the Chairman and non-executive directors' and the dates for next re-election are as follows:

	Date first appointed	Date for election or next re-election
Philip Hampton	19 January 2009	2011
Colin Buchan (1)	1 June 2002	2011
Sandy Crombie	1 June 2009	2011
Penny Hughes	1 January 2010	2011
Joe MacHale	1 September 2004	2011
John McFarlane	1 October 2008	2011
Brendan Nelson	1 April 2010	2011
Art Ryan	1 October 2008	2011
Philip Scott	1 November 2009	2011

Note:

(1) Colin Buchan will stand down as a non-executive director of the Group on 5 August 2011 following the announcement of the Group's interim results, having served just over nine years on the Board.

The non-executive directors do not have service contracts or notice periods although they have letters of engagement reflecting their responsibilities and commitments. These letters make clear to non-executive directors the time commitment they are expected to give to their Board duties. Brendan Nelson, Philip Scott and Penny Hughes' letters of engagement specifically state that their time commitment should be in line with the Walker Review in respect of their general Board duties and additional time as necessary in respect of Committee duties, including in particular any Committees which they chair.

No compensation would be paid to any non-executive director in the event of termination of appointment.

Philip Hampton is entitled to receive a cash payment in lieu of notice if his appointment is terminated as a result of the Group's majority shareholder seeking to effect the termination of his appointment. The applicable notice period is twelve months. In the event that the company terminates Philip Hampton's appointment without good reason, or his re-election is not approved by shareholders in General Meeting resulting in the termination of his appointment, he will be entitled to receive a cash payment in lieu of notice of twelve months' fees.

The tables and explanatory notes on pages 199 to 203 report the remuneration of each director for the year ended 31 December 2010 and have been audited by the company's auditors, Deloitte LLP.

Directors' remuneration

	Salary/ fees £000	Performance bonus £000	Benefits £000	2010 Total £000	2009 Total £000
Chairman					
Philip Hampton (1)	750	—	—	750	700
Executive directors					
Stephen Hester (2)	1,219	2,040	8	3,267	1,227
Bruce Van Saun (2,3,4)	725	1,349	224	2,298	700
Former executive director					
Gordon Pell (5)	233	—	1	234	933

Notes:

(1) Remuneration for 2009 reflects Philip Hampton's appointment as Deputy Chairman and Chairman-designate on 19 January 2009 and his appointment as Chairman on 3 February 2009.

(2) Further information on pension arrangements for Stephen Hester and Bruce Van Saun can be found on page 203.

(3) Remuneration for 2009 reflects Bruce Van Saun's appointment to the Board on 1 October 2009.

(4) Benefits include costs for Bruce Van Saun's relocation to the UK during 2010.

(5) Retired with effect from 31 March 2010.

As disclosed in the 2009 remuneration report, no payment for loss of office was made to Guy Whittaker (who ceased to be a director on 30 September 2009). After leaving the Group, Mr Whittaker was paid a total of £729,381 representing salary and benefits due under his contract of employment for the balance of his notice period.

Gordon Pell is currently Deputy Chairman of Coutts & Co and a non-executive director of RBS Coutts Bank Limited. He receives a combined annual fee of £100,000 in respect of these roles.

The table below sets out the remuneration paid to non-executive directors for the year ended 31 December 2010. No changes were made in relation to non-executive director fees during 2010 except to standardise the Board Risk Committee, Audit Committee and Remuneration Committee membership fee at £25,000 with effect from 1 January 2010. Fees paid to the Chairs of the Board Risk, Audit and Remuneration Committees have also been standardised at £150,000. This constitutes an increase in the fee payable to the Chair of the Remuneration Committee, reflecting the increased workload of that Committee and the time commitment required from the Committee Chair. For individual directors, differences in remuneration between 2009 and 2010 reflect any change in Committee responsibilities and, where applicable, the date they were appointed to the Board during 2009 or 2010, as set out in the notes below.

	Board fees £000	Board Committee fees £000	2010 Total £000	2009 Total £000
Non-executive directors				
Colin Buchan (1)	73	77	150	152

Sandy Crombie (2)	150	—	150	88
Penny Hughes (3)	130	—	130	—
Joe MacHale (4)	73	68	141	111
John McFarlane	73	30	103	93
Brendan Nelson (5)	111	—	111	—
Art Ryan	73	30	103	92
Philip Scott (6)	150	—	150	25
Former non-executive director				
Archie Hunter (7)	24	31	55	166

Notes:
(1) Stepped down as a member and Chairman of the Remuneration Committee on 1 June 2010.
(2) Appointed as Senior Independent Director on 1 June 2009. Fee is inclusive and covers all Board and Board Committee work.
(3) Appointed on 1 January 2010 and became Chair of the Remuneration Committee on 1 June 2010. From 1 June 2010 fee is inclusive and covers all Board and Board Committee work.
(4) Stepped down as a member of the Audit Committee on 30 April 2010. Member of the Asset Protection Scheme Senior Oversight Committee from January 2010.
(5) Appointed on 1 April 2010 and became Chairman of the Audit Committee on 28 April 2010. Fee is inclusive and covers all Board and Board Committee work.
(6) Fee is inclusive and covers all Board and Board Committee work.
(7) Retired with effect from 28 April 2010.

No director received any expense allowances chargeable to UK income tax or compensation for loss of office/termination payment. The non-executive directors did not receive any bonus payments or benefits.

Long-Term Incentive Plan (LTIP)
The LTIP was approved by shareholders in April 2010. It replaced both the ESOP and the MPP. Details of awards made in prior years under the ESOP and MPP are shown on pages 201 and 202. Employees in senior roles (executive level and selected senior management) are eligible to receive annual awards of long-term incentives. The awards will be structured as performance-vesting deferred shares.

The performance conditions for the LTIP awards focus on shareholder value, while factoring in the growing regulatory emphasis on risk-adjusted financial metrics.

	Awards granted in 2010	Market price on award £	Awards vested in 2010	Market price on vesting £	Awards held at 31 December 2010	End of period for qualifying conditions to be fulfilled
Stephen Hester (1)	8,578,432	0.49			8,578,432	14.05.13
Bruce Van Saun (2)	5,182,803	0.49			5,182,803	14.05.13

Notes:
(1) Stephen Hester has agreed to a voluntary holding period of two further years beyond the vesting date for the net post-tax number of vested shares in respect of at least one third of the award.
(2) Bruce Van Saun has agreed to a voluntary holding period of two further years beyond the vesting date for the net post-tax number of vested shares for the amount over 300% of his salary.

No variation was made to any of the terms of the plan during the year.

Performance criteria for awards granted to executive directors under the LTIP in 2010
Awards to executive directors under the LTIP in 2010 are subject to improvement in Economic Profit (50%) as well as relative TSR (25%) and absolute TSR (25%).

Relative TSR
The relative TSR measure compares the Group's performance against a group of comparator banks from the UK and overseas, weighted towards those companies most similar to the Group. The comparator companies and relevant weightings and vesting schedule are the same as those for the 2011 LTIP awards, as set out on page 193.

Absolute TSR
The absolute TSR measure is based on the achievement of share price targets by the end of the performance period.

In respect of the absolute TSR performance measure for the LTIP awards in 2010, vesting is on a straight-line basis and is determined as follows:

- to receive vesting of 100% of the shares, the share price would need to reach 77.5 pence or more;
- to receive 20% of the award (threshold), the share price would need to reach 57.5 pence or more; and
- below 57.5p, vesting would be zero.

Economic profit
Maximum vesting of the economic profit measure will be triggered by early delivery of Core business profitability, well ahead of the range implied by the published Strategic Plan targets and also in excess of the cost of capital.

Risk underpin and clawback
If the Remuneration Committee consider that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect the Group's underlying financial results, or if the Committee considers that the financial results have been achieved with excessive risk, then the terms of the awards allow for an underpin to be used to reduce vesting of an award, or to allow the award to lapse in its entirety.

Awards are subject to clawback.

Deferred awards
In 2009, the Group changed its approach to paying bonuses. Annual awards are now deferred over three years and a portion of the awards will be paid in shares. For executive directors, the entire award is delivered in the form of shares. These steps help to ensure that the interests of those receiving awards are aligned with those of our shareholders. Below are details of deferred awards granted to executive directors during the year ended 31 December 2010. Awards are structured as conditional rights to receive shares and are subject to clawback.

	Awards held at 1 January 2010	Awards granted in 2010	Market price on award £	Awards vested in 2010	Market price on vesting £	Awards held at 31 December 2010	End of period for qualifying conditions to be fulfilled
Bruce Van Saun	—	957,071	0.38			957,071	18.06.12

Stephen Hester agreed to waive his Deferred Awards in 2010.

Share options
The Executive Share Option Plan (ESOP) was approved by shareholders in April 2007. No further awards will be made under the ESOP.

	Options held at 1 January 2010	Options exercised in 2010 Number	Options exercised in 2010 Market price at date of exercise £	Options lapsed in 2010	Option price £	Options held at 31 December 2010 Number	Exercise period
Stephen Hester	9,550,000				0.37	9,550,000	22.06.12 - 21.06.19
Gordon Pell (1)	104,252				4.80	104,252	14.08.04 - 13.08.11
	98,879				5.07	98,879	14.03.05 - 13.03.12
	178,412				3.45	178,412	13.03.06 - 12.03.13
	169,158				4.84	169,158	11.03.07 - 10.03.14
	181,304				4.83	181,304	10.03.08 - 09.03.15
	310,364			310,364	4.70	—	lapsed (2)
	640,871			640,871	2.97	—	lapsed (2)
	1,683,240			951,235		732,005	
Bruce Van Saun	905,306				0.57	905,306	

08.09.12 -
07.09.19

Notes:
(1) Options held at 31 March 2010 when Gordon Pell ceased to be a director.
(2) This award was subject to performance conditions which were not achieved.

No options had their terms and conditions varied during the year ended 31 December 2010. No payment is required on the award of an option.

The plan was amended in 2009 to introduce a clawback provision for grants made in 2009. In respect of the grant of options in 2009, the performance conditions for executive directors are based on a combination of relative and absolute Total Shareholder Return (TSR) measures.

The market price of the company's ordinary shares at 31 December 2010 was 39.07p and the range during the year ended 31 December 2010 was 31.25p to 58.05p.

In the ten year period to 31 December 2010, awards made that could require new issue shares under the company's share plans represented 4.1% of the company's issued ordinary share capital (including the B share capital), leaving an available dilution headroom of 5.9%. The company meets its employee share plan obligations through a combination of new issue shares and market purchase shares.

Medium-Term Performance Plan (MPP)
The MPP was approved by shareholders in April 2001. No further awards will be made under the MPP.

	Scheme interests (share equivalents) at 1 January 2010	Market price on award £	Awards vested in 2010	Awards exercised in 2010	Scheme interests (share equivalents) at 31 December 2010	End of period for qualifying conditions to be fulfilled
Stephen Hester (1)	4,800,000	0.37			4,800,000	22.06.12
Gordon Pell (2)	305,177	2.97			—	lapsed
Bruce Van Saun (3)	1,810,611	0.57			1,810,611	22.06.12

Notes:
(1) Stephen Hester has voluntarily agreed to retain any shares that he receives for a further two years past the vesting date.
(2) Awards held at 31 March 2010 when Gordon Pell ceased to be a director. This award was subject to performance conditions which were not achieved.
(3) End of qualifying period 22 June 2012, however award unavailable for exercise until 8 September 2012, three years from date of award.

No variation was made to any of the terms of the plan during the year.

Restricted Share Award

	Awards held at 1 January 2010	Awards granted in 2010	Market price on award £	Awards vested in 2010	Market price on vesting £	Value of awards vested £	Awards held at 31 December 2010	End of period for qualifying conditions to be fulfilled
Stephen Hester	5,506,987(1)		0.48	469,064	0.4491	210,657		
				695,167	0.4368	303,649		
				879,458	0.3814	335,425	3,463,298	21.11.08 - 29.05.11
	1,221,374(2)		0.48	610,687	0.4050	247,328	610,687	21.11.09 - 21.11.11
	6,728,361			2,654,376		1,097,059	4,073,985	
Philip Hampton (3)	5,172,413		0.29				5,172,413	27.02.12

Notes:
(1) Awards to replace bonus and share awards Stephen Hester forfeited on leaving The British Land Company PLC, which reflect the vesting dates of the original awards. Initially Stephen Hester was awarded 10,407,081 restricted shares on joining the Group.
(2) These awards vest as to 1/3 on each of the first, second and third anniversary of award, subject to their terms.
(3) The Remuneration Committee can amend the award made to Philip Hampton as it considers appropriate. However, shareholder approval will be required to amend certain provisions to his advantage. These provisions relate to the basis for determining his entitlement to, and the terms of shares or other benefits and for the adjustment thereof (if

any) if there is a capitalisation issue, rights issue or open offer, sub-division or consolidation of shares or reduction of capital or any other variation of capital and the amendment power itself. The Remuneration Committee may, without shareholder approval, make minor amendments to facilitate the administration of the award, to comply with or take account of any proposed or existing legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for Philip Hampton or his employer. The benefit of the award is not pensionable. In assessing the performance to determine the vesting of this award, the Remuneration Committee will consider a number of factors which demonstrate whether Philip Hampton has led the successful and sustainable rebuilding of the Group. The Committee will also require to be satisfied that the vesting level is commensurate with the underlying financial performance of the Group.

Directors' pension arrangements

During 2010, Gordon Pell accrued pensionable service in The Royal Bank of Scotland Group Pension Fund (the RBS Fund) until his retirement date of 31 March 2010. The RBS Fund is a defined benefit fund registered with HM Revenue & Customs under the Finance Act 2004.

Gordon Pell was provided with additional pension benefits on a defined benefit basis outwith the RBS Fund. The figures shown below include the accrual in respect of these arrangements.

Disclosure of these benefits has been made in accordance with the United Kingdom Listing Authority's Listing Rules and with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Defined benefit arrangements	Age at 31 December 2010	Accrued entitlement at 31 December 2010 £000 p.a.	Additional pension earned during the year ended 31 December 2010 £000 p.a.	Additional pension earned during the year ended 31 December 2010* £000 p.a.	Transfer value as at 31 December 2010 £000	Transfer value as at 31 December 2009 £000	Increase in transfer value during the year ended 31 December 2010 £000	Transfer value for the additional pension earned during the year ended 31 December 2010 (2) £000
Gordon Pell	60	563	(19)	(19)	12,732	13,581	(849)	(441)

*Net of statutory revaluation applying to deferred pensions.

Notes:

(1) Gordon Pell retired on 31 March 2010. The figures in the table above show his cash equivalent transfer value (CETV) as at the end of the year, using the appropriate factors that would apply at that date. Prior to his retirement and subsequent exchange of part of his pension for a lump sum his accrued pension was £590,940 p.a. at 31 March 2010. The equivalent CETV of this pre-commutation amount was £13,394,000 as at 31 March 2010.

(2) The decrease in pension during the year is a result of the lump sum of £488,579 (plus an additional £91,075 in respect of the excess above his personal lifetime allowance) taken by Gordon Pell on retirement which offset the accrual from 31 December 2009 to 31 March 2010.

Gordon Pell retired from the Group on 31 March 2010, shortly after his normal pension age of 60. His pension at retirement was based on his 39 years of service with Lloyds TSB and with the Group, part of which has been funded by a transfer payment from a Lloyds TSB pension plan. As required by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the value shown above is the value at the end of the year of the residual pension.

There is a significant difference in the form of disclosure required by the Listing Rules and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. The former requires disclosure of the additional pension earned during the period and the transfer value equivalent to this pension based on financial conditions at the end of the period. The latter requires the disclosure of the difference between the transfer value at the start and end of the period and is therefore dependent on the change in financial conditions over that time.

The proportion of benefits represented by funded pension schemes for Gordon Pell is 39%.

Stephen Hester and Bruce Van Saun are provided with a cash allowance in place of pension benefits or have contributions made to a defined contribution pension arrangement, as detailed below:

	2010 £000	2009 £000
Cash allowances in place of pension		
Stephen Hester	420	420
Bruce Van Saun	—	80
Pension contributions to a defined contribution pension arrangement		
Bruce Van Saun	321	—

Project Merlin - disclosure commitments

The Group is committed to increasing the transparency of remuneration within the financial services industry and contributing to an international level playing field on disclosure. In addition to aligning with FSA requirements on remuneration disclosure by 31 December 2011, the Group has enhanced its Directors' Remuneration Report to include the five highest paid senior executive officers as well as maintaining disclosure levels for executive directors.

The data below relates to the five members of the Group's Executive Committee with the highest total remuneration for 2010. For consistency, figures are shown in GBP. Where applicable, currency conversion was based on the 2010 average exchange rate for fixed remuneration and the 31 December 2010 spot rate for bonus figures, in line with the approach taken in this Report.

	Executive A		Executive B		Executive C		Executive D		Executive E	
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Salary (1)		1,779		700		750		750		650
Variable remuneration (cash)	2		2		2		2		2	
Variable remuneration (bond)	488		1,018		253		238		193	
Variable remuneration (shares subject to retention)	490		1,020		255		240		195	
Deferred remuneration (bond)	734		1,530		383		360		293	
Deferred remuneration (shares subject to retention)	734		1,530		383		360		293	
Variable in Executive Reward Schemes (shares) (2)	1,718		133		1,333		1,292		1,000	
Total variable remuneration (3)		4,166		5,233		2,609		2,492		1,976
Total remuneration		5,945		5,933		3,359		3,242		2,626

No sign-on or severance awards have been made during 2010 to any of the above individuals.

Notes:

(1) In addition, the total value of pension and other allowances paid during 2010 for each individual shown in the table above was:

Pension and other allowances	£000
Executive A	736
Executive B	294
Executive C	293
Executive D	647
Executive E	244

(2) Executive Reward Schemes (shares) include long-term incentive awards made following the end of the relevant financial year. The amounts shown reflect two thirds of the grant-date face value of the underlying shares to reflect an approximate performance factor applicable to these awards. The exact number of shares under each award will be based on the share price prior to grant and will therefore be determined at the time of grant.
(3) Variable remuneration reflects the amounts of variable remuneration awarded in respect of the financial year and has been split into different elements based on the deferral position applicable for each employee. Deferral arrangements are compliant with the requirements of the FSA Code.

Penny Hughes
Chair of the Remuneration Committee
23 February 2011

	31 December 2010		
	Shares beneficially owned at 1 January 2010 or date of appointment, if later	Shares beneficially owned	Value (1) £
Chairman			
Philip Hampton	276,312	276,312	107,955
Executive director			
Stephen Hester	2,167,419	3,463,297	1,353,110
Non-executive directors			
Colin Buchan	157,515	157,515	61,541
Sandy Crombie	200,000	200,000	78,140
Penny Hughes	8,175	8,175	3,194
Joe MacHale	284,317	284,317	111,083
John McFarlane	50,000	50,000	19,535
Brendan Nelson	—	120,018	46,891
Art Ryan	50,000	50,000	19,535
Philip Scott	500,000	500,000	195,350

Note:
(1) Value is based on the share price at 31 December 2010, which was 39.07p. During the year ended 31 December 2010 the share price ranged from 31.25p to 58.05p.

No other director had an interest in the company's ordinary shares during the year or held a non-beneficial interest in the shares of the company at 31 December 2010, at 1 January 2010 or date of appointment if later. The interests shown above include connected persons of the directors.

As at 23 February 2011, there were no changes to the directors' interests in shares shown in the table above.

The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the company. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board

Aileen Taylor
Secretary
23 February 2011

We, the directors listed below, confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Business review, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Philip Hampton Stephen Hester Bruce Van Saun

Chairman	Group Chief Executive	Group Finance Director

23 February 2011

Board of directors

Chairman	Executive directors	Non-executive directors
Philip Hampton	Stephen Hester	Colin Buchan
	Bruce Van Saun	Sandy Crombie
		Penny Hughes
		Joe MacHale
		John McFarlane
		Brendan Nelson
		Arthur ‘Art’ Ryan
		Philip Scott

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc

We have audited the accompanying consolidated balance sheets of The Royal Bank of Scotland Group plc and its subsidiaries (together "the Group") as of 31 December 2010, 2009 and 2008 and the related consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated cash flow statements for each of the three years in the period ended 31 December 2010, the notes 1 to 45 and the information identified as 'audited' in the Risk and balance sheet management section of the Business review. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material aspects, the financial position of the Group as at 31 December 2010, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended 31 December 2010, in conformity with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union and IFRS as issued by the International Accounting Standards Board.

Note 45 to the financial statements was added for the inclusion of consolidating financial information in respect of The Royal Bank of Scotland plc in accordance with Regulation S-X Rule 3-10.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of 31 December 2010 based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organisations of the Treadway Commission and our report dated 23 February 2011 expressed an unqualified opinion on the Group's internal control over financial reporting.

/s/ Deloitte LLP
London, United Kingdom
23 February 2011 (31 March 2011 for the consolidating financial information included in Note 45)

Consolidated income statement
for the year ended 31 December 2010

Financial statements

	Note	2010 £m	2009 (1) £m	2008 (1) £m
Interest receivable		22,776	26,311	42,190
Interest payable		(8,567)	(12,923)	(26,708)
Net interest income	1	14,209	13,388	15,482
Fees and commissions receivable	2	8,193	8,738	8,855
Fees and commissions payable	2	(2,211)	(2,790)	(2,444)
Income/(loss) from trading activities	2	4,517	3,761	(9,025)
Gain on redemption of own debt	2	553	3,790	—
Other operating income (excluding insurance net premium income)	2	1,479	873	2,153
Insurance net premium income	26	5,128	5,266	5,709
Non-interest income		17,659	19,638	5,248
Total income		31,868	33,026	20,730
Staff costs				
- excluding curtailment gains		(9,671)	(9,993)	(8,898)
- pension schemes curtailment gains		—	2,148	—
Premises and equipment		(2,402)	(2,594)	(2,163)
Other administrative expenses		(3,995)	(4,449)	(4,716)
Depreciation and amortisation		(2,150)	(2,166)	(2,377)
Write-down of goodwill and other intangible assets		(10)	(363)	(16,911)
Operating expenses	3	(18,228)	(17,417)	(35,065)
Profit/(loss) before other operating charges and impairment losses		13,640	15,609	(14,335)
Insurance net claims	26	(4,783)	(4,357)	(3,917)
Impairment losses	14	(9,256)	(13,899)	(7,439)
Operating loss before tax		(399)	(2,647)	(25,691)
Tax (charge)/credit	6	(634)	429	2,167
Loss from continuing operations		(1,033)	(2,218)	(23,524)
Loss from discontinued operations, net of tax	22	(633)	(105)	(11,018)
Loss for the year		(1,666)	(2,323)	(34,542)
Loss attributable to:				
Non-controlling interests		(665)	349	(10,832)
Preference shareholders	7	105	878	536
Paid-in equity holders	7	19	57	60
Ordinary and B shareholders		(1,125)	(3,607)	(24,306)
		(1,666)	(2,323)	(34,542)
Per ordinary and B share (2)				
Basic loss from continuing operations	10	(0.5p)	(6.3p)	(146.2p)
Diluted loss from continuing operations	10	(0.5p)	(6.3p)	(146.2p)
Basic loss from discontinued operations	10	—	(0.1p)	(0.5p)
Diluted loss from discontinued operations	10	—	(0.1p)	(0.5p)

Dividends	8	—	—	19.3p

Notes:
(1) The Dutch retail and other banking businesses transferred to the Dutch State on 1 April 2010 are recognised as discontinued operations. Comparative information has been changed accordingly.
(2) B shares rank pari-passu with ordinary shares.

The accompanying notes on pages 228 to 331, the accounting policies on pages 216 to 227 and the audited sections of the Business review: Risk and balance sheet management on pages 59 to 164 form an integral part of these financial statements.

for the year ended 31 December 2010

	Note	2010 £m	2009 £m	2008 £m
Loss for the year		(1,666)	(2,323)	(34,542)
Other comprehensive income/(loss)				
Available-for-sale financial assets		(389)	2,016	(7,406)
Cash flow hedges		1,454	684	(1,456)
Currency translation		81	(3,300)	15,425
Actuarial gains/(losses) on defined benefit plans	4	158	(3,665)	(2,287)
Other comprehensive income/(loss) before tax		1,304	(4,265)	4,276
Tax (charge)/credit		(309)	430	2,786
Other comprehensive income/(loss) after tax		995	(3,835)	7,062
Total comprehensive loss for the year		(671)	(6,158)	(27,480)
Total comprehensive loss recognised in the statement of changes in equity is attributable as follows:				
Non-controlling interests		(197)	(1,346)	(4,332)
Preference shareholders		105	878	536
Paid-in equity holders		19	57	60
Ordinary and B shareholders		(598)	(5,747)	(23,744)
		(671)	(6,158)	(27,480)

The accompanying notes on pages 228 to 331, the accounting policies on pages 216 to 227 and the audited sections of the Business review: Risk and balance sheet management on pages 59 to 164 form an integral part of these financial statements.

Balance sheets
as at 31 December 2010

Financial statements

		Group			Company		
		2010	2009	2008	2010	2009	2008
	Note	£m	£m	£m	£m	£m	£m
Assets							
Cash and balances at central banks	11	57,014	52,261	12,400	—	—	—
Loans and advances to banks	11	100,518	91,753	138,197	19,535	31,238	27,031
Loans and advances to customers	11	555,260	728,393	874,722	6,689	2,777	—
Debt securities subject to repurchase agreements	32	80,104	66,883	80,576	—	—	—
Other debt securities		137,376	200,371	186,973	1,454	1,286	—
Debt securities	16	217,480	267,254	267,549	1,454	1,286	—
Equity shares	17	22,198	19,528	26,330	—	—	—
Investments in Group undertakings	18	—	—	—	49,125	64,766	42,196
Settlement balances		11,605	12,033	17,832	—	11	—
Derivatives	15	427,077	441,454	992,559	1,475	1,169	1,168
Intangible assets	19	14,448	17,847	20,049	—	—	—
Property, plant and equipment	20	16,543	19,397	18,949	—	—	—
Deferred tax	25	6,373	7,039	7,082	2	2	3
Prepayments, accrued income and other assets	21	12,576	20,985	24,402	28	43	489
Assets of disposal groups	22	12,484	18,542	1,581	—	—	—
Total assets		1,453,576	1,696,486	2,401,652	78,308	101,292	70,887
Liabilities							
Deposits by banks	11	98,790	142,144	258,044	—	93	1,802
Customer accounts	11	510,693	614,202	639,512	1,029	13,264	26
Debt securities in issue	11	218,372	267,568	300,289	8,742	11,788	14,179
Settlement balances		10,991	10,413	11,741	—	—	—
Short positions	23	43,118	40,463	42,536	—	—	—
Derivatives	15	423,967	424,141	971,364	231	446	361
Accruals, deferred income and other liabilities	24	23,089	30,327	31,482	1,034	1,357	47
Retirement benefit liabilities	4	2,288	2,963	2,032	—	—	—
Deferred tax	25	2,142	2,811	4,165	—	—	—
Insurance liabilities	26	6,794	10,281	9,976	—	—	—
Subordinated liabilities	27	27,053	37,652	49,154	8,048	8,762	10,314
Liabilities of disposal groups	22	9,428	18,890	859	—	—	—
Total liabilities		1,376,725	1,601,855	2,321,154	19,084	35,710	26,729
Non-controlling interests	28	1,719	16,895	21,619	—	—	—
Owners' equity	29,30	75,132	77,736	58,879	59,224	65,582	44,158
Total equity		76,851	94,631	80,498	59,224	65,582	44,158
Total liabilities and equity		1,453,576	1,696,486	2,401,652	78,308	101,292	70,887

The accompanying notes on pages 228 to 331, the accounting policies on pages 216 to 227 and the audited sections of the Business review: Risk and balance sheet management on pages 59 to 164 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 23 February 2011 and signed on its behalf by:

Philip Hampton	Stephen Hester	Bruce Van Saun
Chairman	Group Chief Executive	Group Finance Director

The Royal Bank of Scotland Group plc
Registered No. SC45551

Statements of changes in equity
for the year ended 31 December 2010

Financial statements

	Group			Company		
	2010	2009	2008	2010	2009	2008
	£m	£m	£m	£m	£m	£m
Called-up share capital						
At 1 January	14,630	9,898	2,530	14,630	9,898	2,530
Ordinary shares issued in respect of placing and open offers	—	4,227	5,728	—	4,227	5,728
Ordinary shares issued in respect of rights issue	—	—	1,531	—	—	1,531
Ordinary shares issued in respect of capitalisation issue	—	—	101	—	—	101
B shares issued	—	510	—	—	510	—
Preference shares issued in respect of placing and open offer	—	—	5	—	—	5
Ordinary shares issued	523	—	3	523	—	3
Preference shares redeemed	(1)	(5)	—	(1)	(5)	—
Cancellation of non-voting deferred shares	(27)	—	—	(27)	—	—
At 31 December	15,125	14,630	9,898	15,125	14,630	9,898
Paid-in equity						
At 1 January	565	1,073	1,073	565	1,073	1,073
Securities redeemed	(132)	(308)	—	(132)	(308)	—
Transfer to retained earnings	(2)	(200)	—	(2)	(200)	—
At 31 December	431	565	1,073	431	565	1,073
Share premium account						
At 1 January	23,523	27,471	17,322	23,523	27,471	17,322
Ordinary shares issued in respect of placing and open offer, net of £95 million expenses	—	1,047	—	—	1,047	—
Ordinary shares issued in respect of rights issue, net of £246 million expenses	—	—	10,469	—	—	10,469
Ordinary shares issued in respect of capitalisation issue	—	—	(101)	—	—	(101)
Expenses of placing and open offer	—	—	(265)	—	—	(265)
Ordinary shares issued	281	—	46	281	—	46
Redemption of preference shares classified as debt	118	—	—	118	—	—
Preference shares redeemed	—	(4,995)	—	—	(4,995)	—
At 31 December	23,922	23,523	27,471	23,922	23,523	27,471
Merger reserve						
At 1 January	25,522	10,881	10,881	14,641	—	—
Issue of B shares, net of £399 million expenses	—	24,591	—	—	24,591	—

Placing and open offer	—	—	14,273	—	—	14,273
Transfer to retained earnings	(12,250)	(9,950)	(14,273)	(12,250)	(9,950)	(14,273)
At 31 December	13,272	25,522	10,881	2,391	14,641	—
Available-for-sale reserve						
At 1 January	(1,755)	(3,561)	1,032	—	—	—
Unrealised gains/(losses)	179	1,202	(6,808)	—	—	—
Realised (gains)/losses	(519)	981	842	—	—	—
Tax	74	(377)	1,373	—	—	—
Recycled to profit or loss on disposal of businesses, net of £5 million tax	(16)	—	—	—	—	—
At 31 December	(2,037)	(1,755)	(3,561)	—	—	—
Cash flow hedging reserve						
At 1 January	(252)	(876)	(555)	(1)	(4)	(5)
Amount recognised in equity	180	380	(603)	—	—	—
Amount transferred from equity to earnings	(59)	513	198	1	3	2
Tax	(67)	(269)	84	—	—	(1)
Recycled to profit or loss on disposal of businesses, net of £19 million tax	58	—	—	—	—	—
At 31 December	(140)	(252)	(876)	—	(1)	(4)

Statements of changes in equity
for the year ended 31 December 2010

Financial statements

	Group			Company		
	2010	2009	2008	2010	2009	2008
	£m	£m	£m	£m	£m	£m
Foreign exchange reserve						
At 1 January	4,528	6,385	(426)	—	—	—
Retranslation of net assets	997	(2,322)	11,970	—	—	—
Foreign currency (losses)/gains on hedges of net assets	(458)	456	(5,801)	—	—	—
Tax	63	9	642	—	—	—
Recycled to profit or loss on disposal of businesses	8	—	—	—	—	—
At 31 December	5,138	4,528	6,385	—	—	—
Capital redemption reserve						
At 1 January	170	170	170	170	170	170
Preference shares redeemed	1	—	—	1	—	—
Cancellation of non-voting deferred shares	27	—	—	27	—	—
At 31 December	198	170	170	198	170	170
Contingent capital reserve						
At 1 January	(1,208)	—	—	(1,208)	—	—
Contingent capital agreement - consideration payable	—	(1,208)	—	—	(1,208)	—
At 31 December	(1,208)	(1,208)	—	(1,208)	(1,208)	—
Retained earnings						
At 1 January	12,134	7,542	21,072	13,262	5,550	3,787
Loss attributable to ordinary and B shareholders and other equity owners						
- continuing operations	(973)	(2,600)	(23,624)	(4,554)	(1,503)	(9,602)
- discontinued operations	(28)	(72)	(86)	—	—	—
Ordinary dividends paid	—	—	(2,312)	—	—	(2,312)
Equity preference dividends paid	(105)	(878)	(536)	(105)	(878)	(536)
Paid-in equity dividends paid, net of tax	(19)	(57)	(60)	(19)	(57)	(60)
Transfer from paid-in equity						
- gross	2	200	—	2	200	—
- tax	(1)	—	—	(1)	—	—
Equity owners gain on withdrawal of non-controlling interests						
- gross	40	629	—	—	—	—
- tax	(11)	(176)	—	—	—	—
Redemption of equity preference shares	(2,968)	—	—	(2,968)	—	—
Gain on redemption of equity preference shares	609	—	—	616	—	—
Redemption of preference shares classified as debt	(118)	—	—	(118)	—	—
Transfer from merger reserve	12,250	9,950	14,273	12,250	9,950	14,273

Actuarial gains/(losses) recognised in retirement benefit schemes						
- gross	158	(3,756)	(1,807)	—	—	—
- tax	(71)	1,043	472	—	—	—
Purchase of non-controlling interests	(38)	—	—	—	—	—
Net cost of shares bought and used to satisfy share-based payments	(13)	(16)	(19)	—	—	—
Share-based payments						
- gross	385	325	177	—	—	—
- tax	6	—	(8)	—	—	—
At 31 December	21,239	12,134	7,542	18,365	13,262	5,550
Own shares held						
At 1 January	(121)	(104)	(61)	—	—	—
Shares purchased	(700)	(33)	(64)	—	—	—
Shares issued under employee share schemes	13	16	21	—	—	—
At 31 December	(808)	(121)	(104)	—	—	—
Equity owners at 31 December	75,132	77,736	58,879	59,224	65,582	44,158

Statements of changes in equity for the year ended 31 December 2010 — Financial statements

	Group			Company		
	2010	2009	2008	2010	2009	2008
	£m	£m	£m	£m	£m	£m
Non-controlling interests						
At 1 January	16,895	21,619	38,388	—	—	—
Currency translation adjustments and other movements	(466)	(1,434)	9,256	—	—	—
Acquisition of ABN AMRO	—	—	356	—	—	—
(Loss)/profit attributable to non-controlling interests						
- continuing operations	(60)	382	100	—	—	—
- discontinued operations	(605)	(33)	(10,932)	—	—	—
Dividends paid	(4,200)	(313)	(285)	—	—	—
Movements in available-for-sale securities						
- unrealised (losses)/gains	(56)	299	(1,288)	—	—	—
- realised losses/(gains)	37	(466)	(152)	—	—	—
- tax	5	(36)	(7)	—	—	—
- recycled to profit or loss on disposal of discontinued operations, net of £2 million tax	(7)	—	—	—	—	—
Movements in cash flow hedging reserve						
- amount recognised in equity	(120)	(209)	(1,015)	—	—	—
- amount transferred from equity to earnings	—	—	(36)	—	—	—
- tax	39	59	220	—	—	—
- recycled to profit or loss on disposal of discontinued operations, net of £340 million tax	1,036	—	—	—	—	—
Actuarial gains/(losses) recognised in retirement benefit schemes						
- gross	—	91	(480)	—	—	—
- tax	—	1	2	—	—	—
Equity raised	559	9	1,071	—	—	—
Equity withdrawn and disposals	(11,298)	(2,445)	(13,579)	—	—	—
Transfer to retained earnings	(40)	(629)	—	—	—	—
At 31 December	1,719	16,895	21,619	—	—	—
Total equity at 31 December	76,851	94,631	80,498	59,224	65,582	44,158
Total comprehensive loss recognised in the statement of changes in equity is attributable as follows:						
Non-controlling interests	(197)	(1,346)	(4,332)	—	—	—
Preference shareholders	105	878	536	105	878	536
Paid-in equity holders	19	57	60	19	57	60
Ordinary and B shareholders	(598)	(5,747)	(23,744)	(4,677)	(2,435)	(10,197)
	(671)	(6,158)	(27,480)	(4,553)	(1,500)	(9,601)

The accompanying notes on pages 228 to 331, the accounting policies on pages 216 to 227 and the audited sections of the Business review: Risk and balance sheet management on pages 59 to 164 form an integral part of these financial statements.

Cash flow statements
for the year ended 31 December 2010

Financial statements

		Group			Company		
		2010	2009	2008	2010	2009	2008
	Note	£m	£m	£m	£m	£m	£m
Operating activities							
Operating loss before tax		(399)	(2,647)	(25,691)	(4,471)	(1,286)	(10,017)
Operating loss before tax on discontinued operations		(541)	(49)	(10,937)	—	—	—
Adjustments for:							
Depreciation and amortisation		2,220	2,809	3,154	—	—	—
Write-down of goodwill and other intangible assets		10	363	32,581	—	—	—
Write-down of investment in subsidiaries		—	—	—	5,124	5,139	14,321
Interest on subordinated liabilities		500	1,490	2,144	462	537	499
Charge for defined benefit pension schemes		540	659	490	—	—	—
Pension scheme curtailment gains		(78)	(2,148)	—	—	—	—
Cash contribution to defined benefit pension schemes		(832)	(1,153)	(810)	—	—	—
Gain on redemption of own debt		(553)	(3,790)	—	(53)	(238)	—
Elimination of non-cash items on discontinued activities		—	—	592	—	—	—
Elimination of foreign exchange differences		(691)	12,217	(41,874)	272	(753)	1,778
Other non-cash items		1,455	7,940	8,772	(1)	20	(478)
Net cash flows from trading activities		1,631	15,691	(31,579)	1,333	3,419	6,103
Changes in operating assets and liabilities		17,095	(15,964)	(42,219)	(10,238)	12,537	(22,254)
Net cash flows from operating activities before tax		18,726	(273)	(73,798)	(8,905)	15,956	(16,151)
Income taxes received/(paid)		565	(719)	(1,540)	(133)	409	119
Net cash flows from operating activities	35	19,291	(992)	(75,338)	(9,038)	16,365	(16,032)
Investing activities							
Sale and maturity of securities		47,604	76,492	53,390	—	—	—
Purchase of securities		(43,485)	(73,593)	(55,229)	—	—	—
Investment in subsidiaries		—	—	—	(1,884)	(23,902)	(10,349)
Disposal of subsidiaries		—	—	—	6	7,908	700
Sale of property, plant and equipment		2,011	1,948	2,228	—	—	—
Purchase of property, plant and equipment		(2,113)	(4,898)	(5,757)	—	—	—
Proceeds on disposal of discontinued activities		—	—	20,113	—	—	—
Net investment in business interests and intangible assets	36	3,446	105	2,252	—	—	—
Repayments from subsidiaries		—	—	—	—	274	—
Transfer out of discontinued operations		(4,112)	—	—	—	—	—
Net cash flows from investing activities		3,351	54	16,997	(1,878)	(15,720)	(9,649)
Financing activities							
Issue of ordinary shares		1	—	49	1	—	49
Placing and open offers		—	5,274	19,741	—	5,274	19,741

Rights issue		—	—	12,000	—	—	12,000
Issue of B shares		—	25,101	—	—	12,801	—
Issue of subordinated liabilities		—	2,309	2,413	—	—	—
Proceeds of non-controlling interests issued		559	9	1,427	—	—	—
Redemption of paid-in equity		(132)	(308)	—	(132)	(308)	—
Redemption of preference shares		(2,359)	(5,000)	—	(2,352)	(5,000)	—
Redemption of non-controlling interests		(5,282)	(422)	(13,579)	—	—	—
Shares purchased by employee trusts		(700)	(33)	(64)	—	—	—
Shares issued under employee share schemes		—	—	2	—	—	—
Repayment of subordinated liabilities		(1,588)	(5,145)	(1,727)	(98)	(458)	—
Dividends paid		(4,240)	(1,248)	(3,193)	(124)	(935)	(2,908)
Interest on subordinated liabilities		(639)	(1,746)	(1,967)	(475)	(557)	(466)
Net cash flows from financing activities		(14,380)	18,791	15,102	(3,180)	10,817	28,416
Effects of exchange rate changes on cash and cash equivalents		82	(8,592)	29,209	5	(83)	761
Net increase/(decrease) in cash and cash equivalents		8,344	9,261	(14,030)	(14,091)	11,379	3,496
Cash and cash equivalents at 1 January		144,186	134,925	148,955	16,448	5,069	1,573
Cash and cash equivalents at 31 December	39	152,530	144,186	134,925	2,357	16,448	5,069

The accompanying notes on pages 228 to 331, the accounting policies on pages 216 to 227 and the audited sections of the Business review: Risk and balance sheet management on pages to 59 to 164 form an integral part of these financial statements.

1. Presentation of accounts
The accounts are prepared on a going concern basis (see page 172 of the Report of the directors) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB: the Group's financial statements are prepared in accordance with IFRS as issued by the IASB.

The Group has adopted the revised IFRS 3 'Business Combinations' and related revisions to IAS 27 'Consolidated and Separate Financial Statements' issued in January 2008 and also IFRIC 17 'Distributions of Non-cash Assets to Owners' and the IASB's consequential amendments to IFRS 5 'Non-Current Assets Held for Sale and Discontinued Operations' issued in December 2008. They apply to transactions on or after 1 January 2010 and have not resulted in the restatement of previously published financial information. There have been no material acquisitions in the year. In accordance with IFRS 5, before and after the amendment, the Dutch retail and other banking businesses that were transferred to the Dutch State on 1 April 2010 have been recognised as discontinued operations with consequent changes to the presentation of comparative financial information.

There are a number of other changes to IFRS that were effective from 1 January 2010. They have had no material effect on the Group's financial statements: in April 2009, 'Improvements to IFRS' - making non-urgent but necessary amendments to standards, primarily to remove inconsistencies and to clarify wording; and amendments to IAS 39 'Financial Instruments: Recognition and Measurement' - limited changes to IAS 39 issued in July 2008 clarified that (a) a one-sided risk can be designated as a hedged risk i.e. an option can be used to hedge a risk above or below a specified threshold and (b) inflation can be a hedged risk but only if the cash flows include a specified inflation portion.

The company is incorporated in the UK and registered in Scotland. The accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated as at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

The company accounts are presented in accordance with the Companies Act 2006.

2. Basis of consolidation
The consolidated financial statements incorporate the financial statements of the company and entities (including certain special purpose entities) that are controlled by the Group. Control exists where the Group has the power to govern the financial and operating policies of the entity; generally conferred by holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. Any excess of the cost (the fair value of assets given, liabilities incurred or assumed and equity instruments issued by the Group plus any directly attributable costs) of an acquisition over the fair value of the net assets acquired is recognised as goodwill. The interest of minority shareholders is stated at their share of the fair value of the sub sidiary's net assets.

The results of subsidiaries acquired are included in the consolidated income statement from the date control passes up until the Group ceases to control them through a sale or significant change in circumstances. Changes in interest that do not result in a loss of control are recognised in equity.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared using uniform accounting policies.

3. Revenue recognition
Interest income on financial assets that are classified as loans and receivables, available-for-sale or held-to-maturity and interest expense on financial liabilities other than those at fair value through profit or loss are determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisitio n or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities held-for-trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss together with dividends and interest receivable and payable.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

Payment services - this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account monthly or quarterly in arrears. Income is accrued at period end for services provided but not yet charged.

Card related services - fees from credit card business include:

- Commission received from retailers for processing credit and debit card transactions: income is accrued to the income statement as the service is performed;

- Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place; and

- An annual fee payable by a credit card holder is deferred and taken to profit or loss over the period of the service i.e. 12 months.

Insurance brokerage - this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy, as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

Investment management fees - fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised.

Insurance premiums - see Accounting policy 12.

4. Assets held for sale and discontinued operations

A non-current asset (or disposal group) is classified as held for sale if the Group will recover the carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

The results of discontinued operations are shown as a single amount on the face of the income statement comprising the post-tax profit or loss of discontinued operations and the post-tax gain or loss recognised either on measurement to fair value less costs to sell or on the disposal of the discontinued operation. A discontinued operation is a cash-generating unit or a group of cash-generating units that either has been disposed of, or is classified as held for sale, and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations or (c) is a subsidiary acquired exclusively with a view to resale.

5. Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost, curtailments and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside profit or loss and presented in the consolidated statement of comprehensive income. Contri butions to defined contribution pension schemes are recognised in the income statement when payable.

6. Intangible assets and goodwill
Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in depreciation and amortisation. The estimated useful economic lives are as follows:

Core deposit intangibles	6 to 10 years
Other acquired intangibles	5 to 10 years
Computer software	3 to 5 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Acquired goodwill, being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired, is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries and joint ventures is included in the balance sheet category ‘Intangible assets’ and that on associates within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

7. Property, plant and equipment
Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives.

The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

8. Impairment of intangible assets and property, plant and equipment
At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in

circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been reflected in the estimation of future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. It is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

10. Foreign currencies
The Group's consolidated financial statements are presented in sterling which is the functional currency of the company.

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date.

Foreign exchange differences arising on translation are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in the available-for-sale reserve in equity unless the asset is the hedged item in a fair value hedge.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised directly in equity and included in profit or loss on its disposal.

11. Leases
Contracts to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer. Other contracts to lease assets are classified as operating leases.

Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is credited to the income statement on a receivable basis over the term of the lease. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7).

12. Insurance
General insurance
General insurance comprises short-duration contracts. Due to the nature of the products sold - predominantly property, and motor - the insurance protection is provided on an even basis throughout the term of the policy. Consequently, written premiums are recognised on a straight-line basis over the period of the policy. Insurance premiums exclude insurance premium tax. Unearned premiums represent the proportion of the net premiums that relate to periods of insurance after the balance sheet date and are calculated over the period of exposure under the policy, on a daily basis, 24th's basis or allowing for the estimated incidence of exposure under policies which are longer than twelve months. Provision is made where necessary for the estimated amount of claims over and above unearned premiums including that in respect of future written bus iness on discontinued lines under the run-off of delegated underwriting authority

arrangements. The provision is designed to meet future claims and related expenses and is calculated across related classes of business on the basis of a separate carry forward of deferred acquisition expenses after making allowance for investment income.

Acquisition expenses relating to new and renewed business for all classes are expensed over the period during which the premiums are earned. The principal acquisition costs so deferred are commissions payable, and costs associated with the telesales and underwriting staff. Claims and the related reinsurance are recognised in the accounting period in which the loss occurs. Provision is made for the cost of settling outstanding claims at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date, and claims handling expenses. Provisions are only discounted where claims, principally motor, either have been or are expected to be settled by periodical payments. Related reinsurance receivables are recognised on the same basis and at the same time.

Life assurance

The Group's long-term assurance contracts include whole-life term assurance, endowment assurance, flexible whole-life, pension and annuity contracts that are expected to remain in force for an extended period of time. Long-term assurance contracts under which the Group does not accept significant insurance risk are classified as financial instruments.

The Group recognises the value of in-force long-term assurance contracts as an asset. Cash flows associated with in-force contracts and related assets, including reinsurance cash flows, are projected, using appropriate assumptions as to future mortality, persistency and levels of expenses and excluding the value of future investment margins, to estimate future surpluses attributable to the Group. These surpluses, discounted at a risk-adjusted rate, are recognised as a separate asset. Changes in the value of this asset are included in profit or loss.

Premiums on long-term insurance contracts are recognised as income when receivable. Claims on long-term insurance contracts reflect the cost of all claims arising during the year, including claims handling costs. Claims are recognised when the Group becomes aware of the claim.

Reinsurance

The Group has reinsurance treaties that transfer significant insurance risk. Liabilities for reinsured contracts are calculated gross of reinsurance and a separate reinsurance asset recorded.

13. Provisions
The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the obligations under it exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events whose existence will be confirmed only by uncertain future events or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

14. Tax
Provision is made for tax at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas tax where appropriate. Deferred tax is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

15. Financial assets
On initial recognition, financial assets are classified into held-to-maturity investments; available-for-sale financial assets; held-for-trading; designated as at fair value through profit or loss; or loans and receivables.

Held-to-maturity investments - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Held-for-trading - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

In 2009 and 2008, financial assets designated as at fair value through profit or loss included policyholders' assets underpinning insurance and investment contracts issued by the Group's life assurance businesses. Fair value designation significantly reduces the measurement inconsistency that would arise if these assets were classified as available-for-sale.

Loans and receivables - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

Available-for-sale - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables, are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profi t or loss together with interest calculated using the effective interest method (see Accounting policy 3). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

Reclassifications - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value beco mes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; issues of equity or financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial instruments are recognised on trade date.

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

16. Impairment of financial assets
The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or properties, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment properties. Where the Group’s interest in equity shares following the exchange is such that the Group controlling an entity, that entity is consolidated.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience.

Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For portfolios that are collectively assessed for impairment, the timing of write off principally reflects historic recovery experience for each portfolio. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write offs will be prompted by bankruptcy, insolvency, restructuring and similar events. Most debt is written off within five years of the recognition of the initial impairment. It is not the Group’s usual practice to write-off all or part of the asset at the time an impairm ent loss is recognised; it may however, take place in rare circumstances. Amounts recovered after a loan has been written off are credited to the loan impairment charge for the period in which they are received.

Financial assets carried at fair value - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

17. Financial liabilities
On initial recognition financial liabilities are classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost.

Held-for-trading - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in p rofit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

Financial liabilities designated as at fair value through profit or loss include structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value; and in 2009 and 2008 investment contracts issued by the Group's life assurance businesses: fair value designation significantly reduces the measurement inconsistency that would arise if these liabilities were measured at amortised cost.

Amortised cost - all other financial liabilities are measured at amortised cost using the effective interest method (see Accounting policy 3).

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price times the number of units of the instrument held or issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities.

18. Financial guarantee contracts
Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer’s obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value

less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 13. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

19. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at a value less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

20. Derecognition

A financial asset is derecognised when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If it has not reta ined control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the discounted present value of the cash flows under the new terms with the discounted present value of the remaining cash flows of the original debt issue.

21. Sale and repurchase transactions
Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

22. Netting
Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts; and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

23. Capital instruments
The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms. An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

24. Derivatives and hedging
Derivative financial instruments are initially recognised, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is measured at fair value with changes in fair value recognised in profit or loss.

Gains and losses arising from changes in the fair value of a derivative are recognised as they arise in profit or loss unless the derivative is the hedging instrument in a qualifying hedge. The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued.

Fair value hedge - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Cash flow hedge - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity in the same periods in which the asset or liability affects profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss in equity is recognised in profit or loss when the hedged cash flow occurs or, if the forecast transaction results in the recognition of a financial asset or financial liability, in the same periods during which the asset or liability affects profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss in equity is recognised in profit or loss immediately.

Hedge of net investment in a foreign operation - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised directly in equity. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge.

25. Share-based payments
The Group awards shares and options over shares in The Royal Bank of Scotland Group plc to its employees. The expense for these transactions is measured based on the fair value on the date the awards are granted. The fair value of an option is estimated using valuation techniques which take into account its exercise price, its term, the risk-free interest rate and the expected volatility of the market price of The Royal Bank of Scotland Group plc's shares. Vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting the proportion of awards that actually vest. The fair value is expensed on a straight-line basis over the vesting period. Following an amendment to IFRS 2 for accounting periods starting after 1 January 2009, the cancellation of an award with non-vesting conditions triggers immediate recognitio n of an expense in respect of any unrecognised element of the fair value of the award.

26. Cash and cash equivalents
Cash and cash equivalents comprises cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

27. Shares in Group entities
The company's investments in its subsidiaries are stated at cost less any impairment.

Critical accounting policies and key sources of estimation uncertainty
The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Framework for the Preparation and Presentation of Financial Statements'. The judgements and ass umptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

Loan impairment provisions
The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt restructuring; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2010, gross loans and advances to customers totalled £573,315 million (2009 - £745,519 million; 2008 - £885,611 million) and customer loan impairment provisions amounted to £18,055 million (2009 - £17,126 million; 2008 - £10,889 million).

There are two components to the Group's loan impairment provisions: individual and collective.

Individual component - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include credit card receivables and other personal advances including mortgages. The future credi t quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

Pensions
The Group operates a number of defined benefit pension schemes as described in Note 4 on the accounts. The assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any recognisable surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increases, earnings growth and the longevity of scheme members. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 4 on the accounts, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension asset of £105 million and a liability of £2,288 million were recognised in the balance sheet at 31 December 2010 (2009 - asset - £58 million, liability - £2,963 million; 2008 - asset - £36 million, liability - £2,032 million).

Fair value - financial instruments
Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. Gains or losses arising from changes in the fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised.

Financial instruments measured at fair value include:

Loans and advances (held-for-trading and designated as at fair value though profit or loss) - principally comprise reverse repurchase agreements (reverse repos) and cash collateral.

Debt securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale) - debt securities include those issued by governments, municipal bodies, mortgage agencies and financial institutions as well as corporate bonds, debentures and residual interests in securitisations.

Equity securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale) - comprise equity shares of companies or corporations both listed and unlisted.

Deposits by banks and customer accounts (held-for-trading and designated as at fair value though profit or loss) - deposits measured at fair value principally include repurchase agreements (repos), cash collateral and investment contracts issued by the Group's life assurance businesses.

Debt securities in issue (held-for-trading and designated as at fair value though profit or loss) - principally comprise medium term notes.

Short positions (held-for-trading) - arise in dealing and market making activities where debt securities and equity shares are sold which the Group does not currently possess.

Derivatives - these include swaps (currency swaps, interest rate swaps, credit default swaps, total return swaps and equity and equity index swaps), forward foreign exchange contracts, forward rate agreements, futures (currency, interest rate and equity) and options (exchange-traded options on currencies, interest rates and equities and equity indices and OTC currency and equity options, interest rate caps and floors and swaptions).

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values are determined from quoted prices in active markets for identical financial assets or financial liabilities where these are available. Fair value for a net open position in a financial instrument in an active market is the number of units of the instrument held times the current bid price (for financial assets) or offer price (for financial liabilities). In determining the fair value of derivative financial instruments gross long and short positions measured at current mid market prices are adjusted by bid-offer reserves calculated on a portfolio basis. Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities to reflect the Group's own credit standing. Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. More details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 12 on pages 251 to 265.

General insurance claims
The Group makes provision for the full cost of settling outstanding claims arising from its general insurance business at the balance sheet date, including claims estimated to have been incurred but not yet reported at that date and claims handling expenses. General insurance claims provisions amounted to £6,726 million at 31 December 2010 (2009 - £5,802 million; 2008 - £5,478 million).

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions. In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims at the balance sheet date. Also included in the estimation of outstanding claims are other assumptions such as the inflationary factor used for bodily injury claims which is based on historical trends and, therefore, allows for some increase due to changes in common law and statute; and the incidence of periodical payment orders and the rate at which payments under them are discounted. Costs for both direct and indirect claims handling expenses are also included. Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate. The outstanding claims provision is based on information available to management and the eventual outcome may vary from the original assessment. Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of settling individual claims may exceed that assumed.

Deferred tax
The Group makes provision for deferred tax on short-term and other temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £6,373 million were recognised as at 31 December 2010 (2009 - £7,039 million; 2008 - £7,082 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and short-term timing differences. Deferred tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future taxable profits against which the losses can be utilised. Business projections prepared for impairment reviews (see Note 19) indicate that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within eight years (2009 - eight years). The Group's cumulative losses are principally attributable to the recent unparalleled market conditions. Deferred tax assets of £2,008 million (2009 - £2,163 million; 2008 - £1,748 million) have not been recognised in respect of tax losses carried forward in jurisdictions where doubt exists over the availability of future taxable profits.

Accounting developments

International Financial Reporting Standards

The IASB issued 'Improvements to IFRS' in May 2010 implementing minor changes to IFRS, making non-urgent but necessary amendments to standards, primarily to remove inconsistency and to clarify wording. The revisions are effective for annual periods beginning on or after 1 July 2010 and are not expected to have a material effect on the Group or the company.

The IASB issued IFRS 9 'Financial Instruments' in November 2009 simplifying the classification and measurement requirements in IAS 39 'Financial Instruments: Recognition and Measurement' in respect of financial assets. The standard reduces the measurement categories for financial assets to two: fair value and amortised cost. A financial asset is classified on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. Only assets with contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on the principal amount outstanding and which are held within a business model whose objective is to hold assets in order to collect contractual cash flows are classified as amortised cost. All ot her financial assets are measured at fair value. Changes in the value of financial assets measured at fair value are generally taken to profit or loss.

In October 2010, IFRS 9 was updated to include the classification and measurement of liabilities. It is not markedly different from IAS 39 except for liabilities measured at fair value where the movement is due to changes in credit rating of the preparer it is recognised not in profit or loss but in other comprehensive income.

The standard is effective for annual periods beginning on or after 1 January 2013; early application is permitted.

This standard makes major changes to the framework for the classification and measurement of financial assets and will have a significant effect on the Group's financial statements. The changes relating to the classification and measurement of liabilities carried at fair value will have a less significant effect on the Group. The Group is assessing these impacts which are likely to depend on the outcome of the other phases of IASB's IAS 39 replacement project.

The IASB issued 'Disclosures - Transfers of Financial Assets (Amendments to IFRS 7 Financial Instruments: Disclosures)' in October 2010 to extend the standard's disclosure requirements about derecognition to align with US GAAP. The revisions are effective for annual periods beginning on or after 1 July 2011 and will not affect the financial position or reported performance of the Group or the company.

The IASB issued an amendment to IAS 12 'Income Taxes' in December 2010 to clarify that recognition of deferred tax should have regard to the expected manner of recovery or settlement of the asset or liability. The amendment and consequential withdrawal of SIC 21 'Deferred Tax: Recovery of Underlying Assets', effective for annual periods beginning on or after 1 January 2012, is not expected to have a material effect on the Group or the company.

The International Financial Reporting Interpretations Committee issued IFRIC 19 'Extinguishing Financial Liabilities with Equity Instruments' in December 2009. The interpretation clarifies that the profit or loss on extinguishing liabilities by issuing equity instruments should be measured by reference to fair value, preferably of the equity instruments. The interpretation, effective for the Group for annual periods beginning on or after 1 January 2011, is not expected to have a material effect on the Group or the company.

1 Net interest income

	Group		
	2010	2009	2008
	£m	£m	£m
Loans and advances to customers	18,889	21,356	34,949
Loans and advances to banks	591	830	2,201
Debt securities	3,296	4,125	5,040
Interest receivable	22,776	26,311	42,190
Customer accounts: demand deposits	1,228	970	3,475
Customer accounts: savings deposits	1,148	1,245	2,261
Customer accounts: other time deposits	1,345	2,546	7,906
Deposits by banks	1,333	2,898	6,362
Debt securities in issue	3,277	4,482	8,919
Subordinated liabilities	417	1,291	1,959
Internal funding of trading businesses	(181)	(509)	(4,174)
Interest payable	8,567	12,923	26,708
Net interest income	14,209	13,388	15,482

2 Non-interest income (excluding insurance net premium income)

	Group		
	2010	2009	2008
	£m	£m	£m
Fees and commissions receivable	8,193	8,738	8,855
Fees and commissions payable			
- banking	(1,892)	(2,351)	(2,043)
- insurance related	(319)	(439)	(401)
	(2,211)	(2,790)	(2,444)
Income/(loss) from trading activities (1)			
Foreign exchange	1,491	2,340	1,906
Interest rate	1,862	3,883	1,026
Credit	41	(4,147)	(12,207)
Other	1,123	1,685	250
	4,517	3,761	(9,025)
Gain on redemption of own debt (2)	553	3,790	—
Other operating income (excluding insurance net premium income)			
Operating lease and other rental income	1,394	1,323	1,469
Changes in the fair value of own debt attributable to own credit (3)	249	51	977
Changes in the fair value of securities and other financial assets and liabilities	(180)	42	(1,266)
Changes in the fair value of investment properties	(405)	(117)	(86)
Profit on sale of securities	496	162	164
Profit on sale of property, plant and equipment	50	40	177
(Loss)/profit on sale of subsidiaries and associates	(107)	(144)	934
Life business profits/(losses)	90	156	(52)
Dividend income	69	78	276
Share of profits less losses of associated entities	70	(268)	45
Other income (4)	(247)	(450)	(485)
	1,479	873	2,153

Notes:

(1) The analysis of trading income/(loss) is based on how the business is organised and the underlying risks managed. Trading income/(loss) comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs.

The types of instruments include:

- Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
- Interest rate: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
- Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
- Other: equities, commodities, equity derivatives, commodity contracts and related hedges and funding.

(2) In May 2010, the Group redeemed certain subordinated debt securities and equity preference shares in exchange for cash or senior debt. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability. Gains on

these exchanges and on the redemption of securities classified as liabilities for cash, totalling £553 million were credited to profit or loss. No amounts have been recognised in profit or loss in relation to the redemption of securities classified as equity in the Group financial statements. The difference between the consideration and the carrying value for these securities amounting to £651 million has been recorded in equity. A similar series of exchange and tender offers completed in April 2009 and resulted in a gain of £3,790 million being credited to profit or loss and £829 million being recorded in equity.

(3) Measured as the change in fair value from movements in the period in the credit risk premium payable by the Group.

(4) Includes income from activities other than banking and insurance.

3 Operating expenses

	Group		
	2010	2009	2008
	£m	£m	£m
Wages, salaries and other staff costs	7,945	8,039	7,471
Bonus tax	99	208	—
Social security costs	661	675	648
Share-based compensation	397	329	169
Pension costs			
- defined benefit schemes (see Note 4)	519	638	473
- curtailment gains (see Note 4)	(78)	(2,148)	—
- defined contribution schemes	128	104	137
Staff costs	9,671	7,845	8,898
Premises and equipment	2,402	2,594	2,163
Other administrative expenses	3,995	4,449	4,716
Property, plant and equipment (see Note 20)	1,428	1,427	1,406
Intangible assets (see Note 19)	722	739	971
Depreciation and amortisation	2,150	2,166	2,377
Write-down of goodwill and other intangible assets	10	363	16,911
	18,228	17,417	35,065

Integration costs included in operating expenses comprise expenditure incurred in respect of cost reduction and revenue enhancement programmes connected with acquisitions made by the Group.

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

Restructuring costs included in operating expenses comprise:

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

Divestment costs included in operating expenses comprise:

	2010	2009	2008

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

3 Operating expenses continued

The average number of persons employed, rounded to the nearest hundred, in the continuing operations of the Group during the year, excluding temporary staff, was 153,400 (2009 - 166,400; 2008 - 175,400); on the same basis discontinued operations employed 6,200 employees (2009 - 28,100; 2008 - 58,300). The average number of temporary employees during 2010 was 11,600 (2009 - 9,700; 2008 - 7,000). The number of persons employed in the continuing operations of the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2010	2009	2008
UK Retail	26,300	28,500	31,700
UK Corporate	13,000	12,600	13,600
Wealth	5,300	4,800	5,300
Global Transaction Services	2,400	3,200	3,600
Ulster Bank	4,400	4,600	5,600
US Retail & Commercial	16,500	16,400	17,300
Global Banking & Markets	15,500	15,100	15,700
RBS Insurance	15,000	14,600	15,300
Central items	4,300	3,800	4,300
Core	102,700	103,600	112,400
Non-Core	6,400	13,700	15,000
	109,100	117,300	127,400
Business Services	36,100	41,600	44,500
Integration	300	500	900
RFS Holdings minority interest	—	300	200
Total	145,500	159,700	173,000
UK	93,000	98,400	105,600
USA	23,900	25,600	27,100
Europe	10,800	12,600	14,400
Rest of the World	17,800	23,100	25,900
Total	145,500	159,700	173,000

There were no persons employed in discontinued operations as at 31 December 2010 (2009 - 24,800; 2008 - 29,100).

Share-based payments

As described in the Remuneration report on pages 189 to 204, the Group grants share-based awards to employees principally on the following bases:

Award plan	Eligible employees	Nature of award (1)	Vesting conditions (2)	Issue dates
Sharesave	UK, Republic of Ireland, Channel Islands, Gibraltar and Isle of Man	Option to buy shares under employee savings plan	Continuing employment or leavers in certain circumstances	2011 to 2018
Deferred performance awards	All	Awards of ordinary shares	Continuing employment or leavers in certain circumstances	2011 to 2014
	Senior employees			

Restricted share awards		Awards of conditional shares	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2011 to 2014
Long-term incentives (3)	Senior employees	Awards of conditional shares or share options	Continuing employment or leavers in certain circumstances and/or achievement of performance conditions	2011 to 2020

Notes:

(1) Awards are equity-settled unless international comparability is better served by cash-settled awards.

(2) All awards have vesting conditions and therefore some may not vest.

(3) Long-term incentives include the Executive Share Option Plan, the Long-Term Incentive Plan and the Medium-Term Performance Plan.

(4) The strike price of options and the fair value on granting awards of fully paid shares is the average market price over the five trading days preceding grant date.

Sharesave

	2010		2009	
	Average exercise price £	Shares under option (million)	Average exercise price £	Shares under option (million)
At 1 January	0.50	1,038	2.88	84
Granted	0.43	147	0.38	1,176
Exercised	0.38	(5)	—	—
Lapsed	0.45	(168)	0.77	(222)
At 31 December	0.48	1,012	0.50	1,038

Options are exercisable within six months of vesting; 23 million were exercisable at 31 December 2010 (2009 - 26 million). The weighted average share price at the date of exercise of options was 45p (2009 - not applicable). At 31 December 2010, exercise prices ranged from 38p to 393p and the average contractual life was 3.3 years (2009 - 38p to 393p and 3.2 years). The fair value of options granted in 2010 was £48 million (2009 - £220 million).

Deferred performance awards

	2010	
	Value at grant £m	Shares awarded (million)
At 1 January	—	—
Granted	1,043	2,755
Forfeited	(34)	(90)
At 31 December	1,009	2,665

None of the share awards vested in 2010. The awards granted in 2010 vest evenly over the following two anniversaries.

Restricted share awards

	2010		2009	
	Value at grant £m	Shares awarded (million)	Value at grant £m	Shares awarded (million)
At 1 January	117	325	48	31
Granted	26	55	94	309
Exercised	(6)	(15)	(16)	(5)
Lapsed	(27)	(30)	(9)	(10)
At 31 December	110	335	117	325

The market value of awards exercised in 2010 was £6 million (2009 - £2 million).

Long-term incentives

	2010			2009		
	Value at grant £m	Shares awarded (million)	Options over shares	Value at grant £m	Shares awarded (million)	Options over shares

			(million)			(million)
At 1 January	122	7	413	79	1	92
Granted	115	247	3	70	8	353
Exercised	—	—	(1)	—	—	—
Lapsed	(18)	(4)	(38)	(27)	(2)	(32)
At 31 December	219	250	377	122	7	413

The market value of awards exercised in 2010 was less than £1 million (2009 - nil). There are vested options over 33 million shares exercisable up to 2020 (2009 - 33 million shares up to 2014).

At 31 December 2010 a provision of £6 million had been made in respect of 16 million share awards and 3 million options over shares that may be cash-settled (2009 - £6 million in respect of 16 million share awards and 3 million options over shares).

The fair value of options granted in 2010 was determined using a pricing model that included: expected volatility of shares determined at the grant date based on historic volatility over a period of up to seven years; an expected option lives that equal the vesting period; no dividends on equity shares; and a risk-free interest rate determined from the UK gilt rates with terms matching the expected lives of the options.

4 Pension costs

The Group sponsors a number of pension schemes in the UK and overseas, predominantly defined benefit schemes, whose assets are independent of the Group's finances. The principal defined benefit scheme is The Royal Bank of Scotland Retirement Fund (the "Main scheme") which accounts for 84% (2009 - 61%; 2008 - 56%) of the Group's retirement benefit obligations.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees do not make contributions for basic pensions but may make voluntary contributions to secure additional benefits on a money-purchase basis. Since October 2006, the Main scheme has been closed to new entrants who have instead been offered membership of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. In 2009, pensionable salary increases in the Main scheme and certain other UK and Irish schemes were limited to 2% per annum or CPI inflation if lower.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

Interim valuations of the Group's schemes under IAS 19 'Employee Benefits' were prepared to 31 December with the support of independent actuaries, using the following assumptions:

Principal actuarial assumptions at 31 December (weighted average)	Main scheme			All schemes		
	2010	2009	2008	2010	2009	2008
Discount rate	5.5%	5.9%	6.5%	5.4%	5.7%	6.0%
Expected return on plan assets	6.7%	6.8%	7.1%	6.3%	6.1%	6.3%
Rate of increase in salaries	1.8%	1.8%	4.0%	2.0%	2.0%	3.4%
Rate of increase in pensions in payment	3.3%	3.5%	2.7%	3.0%	3.0%	2.4%
Inflation assumption	3.3%	3.5%	2.7%	3.2%	3.0%	2.4%

	Main scheme			All schemes		
Major classes of plan assets as a percentage of total plan assets	2010	2009	2008	2010	2009	2008
Quoted equities	25.9%	38.9%	52.9%	28.2%	36.2%	38.0%
Private equity	5.4%	5.1%	6.5%	4.5%	3.1%	3.7%
Index-linked bonds	27.0%	23.7%	18.0%	24.1%	15.2%	11.4%
Government fixed interest bonds	—	—	1.2%	1.9%	18.9%	23.2%
Corporate and other bonds	26.2%	19.7%	18.5%	24.8%	14.7%	15.1%
Hedge funds	3.2%	3.6%	—	3.5%	3.1%	0.8%
Property	3.4%	3.5%	3.7%	3.6%	3.6%	3.9%
Derivatives	0.9%	—	(1.8%)	1.2%	0.8%	1.5%
Cash and other assets	7.8%	5.3%	1.0%	8.1%	4.3%	2.4%
Equity exposure of equity futures	25.6%	10.6%	—	21.4%	6.3%	—
Cash exposure of equity futures	(25.4%)	(10.4%)	—	(21.3%)	(6.2%)	—
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The Main scheme, which represents 84% of plan assets at 31 December 2010 following the divestment during 2010 of ABN AMRO's principal pension scheme in the Netherlands (2009 - 59%; 2008 - 57%), is invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property and hedge funds. The Main scheme also employs derivative instruments, where appropriate, to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the actual physical assets held by the scheme, with any derivative holdings valued on a mark-to-market basis. The return on assets on the total scheme has been based on the asset exposure created allowing for the net impact of the derivatives on the risk and return profile of the holdings.

The Main scheme's holdings of derivative instruments are summarised in the table below:

	2010			2009			2008		
	Notional amounts	Fair value Assets	Fair value Liabilities	Notional amounts	Fair value Assets	Fair value Liabilities	Notional amounts	Fair value Assets	Fair value Liabilities
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Inflation rate swaps	2,132	69	8	1,171	75	3	947	1	43
Interest rate swaps	10,727	270	110	4,893	46	114	868	18	—
Total return swaps	466	16	—	—	—	—	—	—	—
Currency swaps	(973)	—	1	—	—	—	—	—	—
Equity futures	4,851	49	14	1,730	37	—	15	—	—
Currency forwards	4,883	35	91	2,908	58	70	1,966	21	267

The investment strategy of other schemes is similar to that of the Main scheme, adjusted to take account of the nature of liabilities, risk appetite of the trustees, size of the scheme and any local regulatory constraints. The use of derivative instruments outside of the Main scheme is not material.

Swaps are part of the management of the inflation and interest rate sensitivity of the Main scheme liabilities. They have been executed at prevailing market rates and within standard market bid/offer spreads. Substantially all swaps are with The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2010, the gross notional value of the swaps was £12,352 million (2009 - £6,064 million; 2008 - £1,815 million) and had a net positive fair value of £236 million (2009 - £4 million positive; 2008 - £24 million negative) to the scheme.

Collateral is required on all swap transactions with those between the banks and the Main scheme on terms that do not allow the banks to re-hypothecate. The banks had delivered £210 million of collateral at 31 December 2010 (2009 - held £6 million; 2008 - held £36 million).

Ordinary shares of the company with a fair value of £9 million (2009 - £4 million; 2008 - £15 million) are held by the Group's Main scheme which also holds other financial instruments issued by the Group with a value of £264 million (2009 - £192 million; 2008 - £421 million).

The expected return on plan assets at 31 December is based upon the weighted average of the following assumed returns on the major classes of plan assets, allowing for the net impact of derivatives on the risk and return profile:

	Main scheme			All schemes		
	2010	2009	2008	2010	2009	2008
Quoted equities	7.7%	8.0%	8.4%	7.5%	7.8%	8.4%
Private equity	7.7%	8.0%	8.4%	7.7%	8.0%	8.4%
Index-linked bonds	4.2%	4.5%	3.9%	4.0%	4.5%	3.9%
Government fixed interest bonds	—	—	3.9%	2.9%	4.0%	4.3%
Corporate and other bonds	5.5%	5.9%	6.1%	5.2%	5.8%	5.7%
Hedge funds	6.0%	6.2%	—	5.3%	4.3%	8.4%
Property	6.7%	6.2%	6.1%	6.4%	6.0%	6.1%
Derivatives	0.0%	0.0%	2.5%	0.0%	0.0%	2.5%
Cash and other assets	4.0%	4.2%	2.5%	3.7%	3.8%	5.1%
Equity exposure of equity futures	7.7%	8.0%	—	7.7%	8.0%	—
Cash exposure of equity futures	4.0%	4.2%	—	4.0%	4.2%	—

Total fund	6.7%	6.8%	7.1%	6.3%	6.1%	6.3%

Post-retirement mortality assumptions (Main scheme)	2010	2009	2008
Longevity at age 60 for current pensioners (years)			
Males	27.2	27.1	26.1
Females	29.6	29.5	26.9
Longevity at age 60 for future pensioners currently aged 40 (years)			
Males	29.3	29.2	28.1
Females	30.8	30.8	28.2

4 Pension costs continued

Changes in value of net pension deficit/(surplus)	Main scheme Fair value of plan assets £m	Main scheme Present value of defined benefit obligations £m	Main scheme Net pension deficit/ (surplus) £m	All schemes Fair value of plan assets £m	All schemes Present value of defined benefit obligations £m	All schemes Net pension deficit/ (surplus) £m
At 1 January 2009	14,804	15,594	790	25,756	27,752	1,996
Currency translation and other adjustments	—	—	—	(699)	(813)	(114)
Income statement						
Expected return	1,029		(1,029)	1,553		(1,553)
Interest cost		999	999		1,614	1,614
Current service cost		300	300		583	583
Past service cost		15	15		15	15
Gains on curtailments		(1,947)	(1,947)		(2,148)	(2,148)
	1,029	(633)	(1,662)	1,553	64	(1,489)
Statement of comprehensive income						
- Actuarial gains and losses	993	4,473	3,480	1,344	5,009	3,665
Contributions by employer	536	—	(536)	1,153	—	(1,153)
Contributions by plan participants and other scheme members	2	2	—	15	15	—
Benefits paid	(741)	(741)	—	(1,175)	(1,175)	—
Expenses included in service cost	(20)	(20)	—	(22)	(22)	—
At 1 January 2010	16,603	18,675	2,072	27,925	30,830	2,905
Currency translation and other adjustments	—	—	—	(206)	(206)	—
Income statement						
Expected return	1,114		(1,114)	1,428		(1,428)
Interest cost		1,091	1,091		1,402	1,402
Current service cost		345	345		499	499
Past service cost		76	76		67	67
Gains on curtailments		—	—		(78)	(78)
	1,114	1,512	398	1,428	1,890	462
Statement of comprehensive income						
- Actuarial gains and losses	1,718	1,674	(44)	1,797	1,639	(158)
Disposal of subsidiaries	—	—	—	(7,993)	(8,187)	(194)
Contributions by employer	444	—	(444)	832	—	(832)
Contributions by plan participants and other scheme members	—	—	—	10	10	—
Benefits paid	(716)	(716)	—	(922)	(922)	—
Expenses included in service cost	(53)	(53)	—	(55)	(55)	—
At 31 December 2010	19,110	21,092	1,982	22,816	24,999	2,183

Net pension deficit/(surplus) comprises	2010 £m	2009 £m	2008 £m

Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 21)	(105)	(58)	(36)
Net liabilities of schemes in deficit	2,288	2,963	2,032
	2,183	2,905	1,996

The pension charge/(credit) to the income statement comprises:

	2010 £m	2009 £m	2008 £m
Continuing operations	441	(1,510)	473
Discontinued operations	21	21	17
	462	(1,489)	490

Curtailment gains of £78 million have been recognised in 2010 arising from changes to pension benefits in a subsidiary's scheme. Curtailment gains of £2,148 million were recognised in 2009 arising from changes to pension benefits in the Main scheme and certain other subsidiaries' schemes due to the capping of future salary increases that will count for pension purposes to the lower of 2% or the rate of CPI inflation in any year. The curtailment gains in 2009 were separately disclosed on the face of the income statement due to their size.

Following the legal separation of ABN AMRO Bank N.V. on 1 April 2010, ABN AMRO's principal pension scheme in the Netherlands was transferred to the State of the Netherlands. At 31 December 2009, this scheme had fair value of plan assets of £8,118 million (2008 - £8,181 million) and present value of defined benefit obligations of £8,298 million (2008 - £8,589 million). The principal actuarial assumptions at 31 December 2009 were: discount rate 5.25% (2008 - 5.4%); expected return on plan assets (weighted average) 5.25% (2008 - 5.25%); rate of increase in salaries 2.5% (2008 - 2.5%); rate of increase in pensions in payment 2.0% (2008 - 2.0%); and inflation assumption 2.0% (2008 - 2.0%).

The Group expects to contribute £500 million to its defined benefit pension schemes in 2011 (Main scheme - £333 million). Of the net liabilities of schemes in deficit, £161 million (2009 - £198 million; 2008 - £201 million) relates to unfunded schemes.

The most recent funding valuation of the Main UK scheme was 31 March 2007. A funding valuation of the Main UK scheme at 31 March 2010 is currently in progress. The scheme trustees and the Group are in discussion on this valuation and the level of contributions to be paid by the Group and expect to reach agreement by 30 June 2011. The Group expects that in addition to estimated contributions of £300 - £350 million for future accrual of benefits, it will make additional contributions, as yet unquantified, in 2011 and subsequent years to improve the funding position of the scheme.

Cumulative net actuarial losses of £4,224 million (2009 - £4,382 million losses; 2008 - £717 million gains) have been recognised in the statement of comprehensive income, of which £3,252 million losses (2009 - £3,296 million losses; 2008 - £184 million gains) relate to the Main scheme.

	Main scheme					All schemes				
History of defined benefit schemes	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Fair value of plan assets	19,110	16,603	14,804	18,575	17,374	22,816	27,925	25,756	27,662	18,959
Present value of defined benefit obligations	21,092	18,675	15,594	18,099	19,004	24,999	30,830	27,752	27,547	20,951
Net deficit/(surplus)	1,982	2,072	790	(476)	1,630	2,183	2,905	1,996	(115)	1,992
	(858)	135	(55)	(256)	(4)	(882)	328	(65)	(210)	(19)

Experience (losses)/gains on plan liabilities										
Experience gains/(losses) on plan assets	1,718	993	(4,784)	163	552	1,797	1,344	(6,051)	19	587
Actual return/(loss) on pension schemes assets	2,832	2,022	(3,513)	1,345	1,574	3,225	2,897	(4,186)	1,413	1,660
Actual return/(loss) on pension schemes assets - %	17.2%	13.8%	(19.0%)	7.8%	9.9%	15.6%	11.4%	(14.5%)	6.9%	9.6%

4 Pension costs continued

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at 31 December to a change in the principal actuarial assumptions:

	Main scheme Increase/(decrease)						All schemes Increase/(decrease)					
	in pension cost for year			in obligation at 31 December			in pension cost for year			in obligation at 31 December		
	2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
0.25% increase in the discount rate	(17)	(21)	(37)	(925)	(790)	(696)	(42)	(41)	(53)	(1,245)	(1,261)	(1,161)
0.25% increase in inflation	59	49	77	799	654	624	89	93	114	1,106	1,143	1,089
0.25% additional rate of increase in pensions in payment	37	33	41	527	442	383	43	47	63	599	596	695
0.25% additional rate of increase in deferred pensions	21	16	8	265	214	94	44	25	15	497	366	227
0.25% additional rate of increase in salaries	6	8	28	56	66	168	30	17	35	270	125	219
Longevity increase of 1 year	34	29	31	519	416	302	59	50	50	781	734	700

5 Auditor's remuneration

Amounts paid to the Group's auditors for statutory audit and other services are set out below. All audit related and other services are approved by the Audit Committee and are subject to strict controls to ensure the external auditor's independence is unaffected by the provision of other services. The Audit Committee recognise that for certain assignments the auditors are best placed to perform the work economically; for other work the Group selects the supplier best placed to meet its requirements. The Group's auditors are permitted to tender for such work in competition with other firms where the work is permissible under audit independence rules.

	Group	
	2010	2009
	£m	£m
Audit services		
- statutory audit (1)	30.0	41.3
- audit related including regulatory reporting (2)	3.2	3.3
	33.2	44.6
Tax services		
- compliance services	0.3	1.1
- advisory services	0.2	0.3
	0.5	1.4
All other services (3)	9.3	7.5
Total	43.0	53.5

Notes:

(1) The prior year fees include £21.9 million in respect of the audit of ABN AMRO Holdings N.V., of which £8.8 million related to the interests of the State of the Netherlands and Santander.

(2) Includes fees of £1.2 million (2009 - £1.7 million) in relation to reviews of interim financial information and £2.0 million (2009 - £1.6 million) in respect of reports to the Group's regulators in the UK and overseas.

(3) Includes fees of £0.5 million (2009 - £2.1 million) in respect of work performed by the auditors as reporting accountants on debt and equity issuances undertaken by the Group, including securitisations and fees of £2.9 million (2009 - nil) in respect of audit and assurance of financial information in connection with disposals by the Group.

6 Tax

	Group		
	2010	2009	2008
	£m	£m	£m
Current tax			
Charge for the year	(251)	(494)	(1,386)
Over provision in respect of prior periods	41	191	254
Relief for overseas tax	—	—	34
	(210)	(303)	(1,098)
Deferred tax			
(Charge)/credit for the year	(738)	1,041	3,167
Over/(under) provision in respect of prior periods	314	(309)	98
Tax (charge)/credit for the year	(634)	429	2,167

The actual tax (charge)/credit differs from the expected tax credit computed by applying the standard rate of UK corporation tax of 28% (2009 - 28%; 2008 - 28.5%) as follows:

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

Notes:

(1) Prior year tax adjustments include releases of tax provisions in respect of structured transactions and investment disposals, and adjustments to reflect submitted tax computations in the UK and overseas.

(2) In the Budget on 22 June 2010, the UK Government proposed, amongst other things, to reduce Corporation Tax rates in four annual decrements of 1% with effect from 1 April 2011. The first decrement was enacted in the Finance (No 2) Act 2010 and as a consequence the closing deferred tax assets and liabilities have been recognised at an effective rate of 27%. The impact of this change on the tax charge for the year is set out in the table above.

7 Profit attributable to preference shareholders and paid-in equity holders

	Group		
	2010	2009	2008

	£m	£m	£m
Preference shareholders			
Non-cumulative preference shares of US$0.01	105	342	293
Non-cumulative preference shares of €0.01	—	201	183
Non-cumulative preference shares of £1			
- issued to UK Financial Investments Limited (1)	—	274	—
- other	—	61	60
Paid-in equity holders			
Interest on securities classified as equity, net of tax	19	57	60
Total	124	935	596

Note:

(1) Includes £50 million redemption premium on repayment of preference shares.

8 Ordinary dividends

The company did not pay an ordinary dividend in 2010 or 2009. In 2008, the company paid a final dividend, in respect of 2007, of 19.3p per ordinary share (restated for the effect of the rights issue in June 2008 and the capitalisation issue in September 2008) amounting to £2,312 million.

9 Profit dealt with in the accounts of the company

As permitted by section 408(3) of the Companies Act 2006, the primary financial statements of the company do not include an income statement or statement of comprehensive income. Condensed information is set out below:

	2010	2009	2008
Income statement	£m	£m	£m
Dividends received from banking subsidiary	60	2,523	4,639
Dividends received from other subsidiaries	24	408	163
Gain on redemption of own debt	53	238	—
Total income	137	3,169	4,802
Interest receivable from subsidiaries	1,042	997	793
Interest payable to subsidiaries	(263)	(251)	(495)
Other net interest payable and operating expenses	(263)	(62)	(796)
Write-down of investments in subsidiaries	(5,124)	(5,139)	(14,321)
Operating loss before tax	(4,471)	(1,286)	(10,017)
Tax (charge)/credit	(83)	(217)	415
Loss for the year	(4,554)	(1,503)	(9,602)
Loss attributable to:			
Preference shareholders	105	878	536
Paid-in equity holders	19	57	60
Ordinary and B shareholders	(4,678)	(2,438)	(10,198)
	(4,554)	(1,503)	(9,602)

	2010	2009	2008
Statement of comprehensive income	£m	£m	£m
Loss for the year	(4,554)	(1,503)	(9,602)
Other comprehensive income			
Cash flow hedges	1	3	2
Tax on comprehensive income	—	—	(1)
Other comprehensive income for the year, net of tax	1	3	1
Total comprehensive loss for the year	(4,553)	(1,500)	(9,601)
Attributable to:			
Preference shareholders	105	878	536
Paid-in equity holders	19	57	60
Ordinary and B shareholders	(4,677)	(2,435)	(10,197)
Total comprehensive loss for the year	(4,553)	(1,500)	(9,601)

10 Earnings per ordinary and B share

Earnings per ordinary and B share have been calculated based on the following:

	Group		
	2010	2009	2008
	£m	£m	£m
Earnings			
Loss attributable to ordinary and B shareholders	(1,125)	(3,607)	(24,306)
Loss from discontinued operations attributable to ordinary and B shareholders	28	72	86
Gain on redemption of preference shares and paid-in equity	610	200	—
Loss from continuing operations attributable to ordinary and B shareholders	(487)	(3,335)	(24,220)
Weighted average number of shares (millions)			
Ordinary shares in issue during the year	56,245	51,494	16,563
B shares in issue during the year	51,000	1,397	—
Weighted average number of ordinary and B shares in issue during the year (1)	107,245	52,891	16,563

Note:

(1) Following reconsideration of the terms of the B share subscription agreement with HM Treasury, it is no longer treated as dilutive. The comparative amount for the year ended 31 December 2009 has been restated.

The number of shares in issue in 2008 was adjusted retrospectively for the bonus element of the rights issue completed in June 2008 and the capitalisation issue in September 2008. None of the convertible securities had a dilutive effect in 2010, 2009 or 2008.

11 Financial instruments - classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Group								
2010	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	57,014				57,014
Loans and advances to banks									
- reverse repos	38,215	—		—	4,392				42,607
- other (1)	26,082	—		—	31,829				57,911
Loans and advances to customers									
- reverse repos	41,110	—		—	11,402				52,512
- other (2)	19,903	1,100		—	471,308		10,437		502,748
Debt securities	98,869	402		111,130	7,079				217,480
Equity shares	19,186	1,013		1,999	—				22,198
Settlement balances	—	—		—	11,605				11,605
Derivatives	421,648		5,429		—				427,077
Intangible assets								14,448	14,448
Property, plant and equipment								16,543	16,543
Deferred tax								6,373	6,373
Prepayments, accrued income and other assets	—	—		—	1,306			11,270	12,576
Assets of disposal groups								12,484	12,484
	665,013	2,515	5,429	113,129	595,935		10,437	61,118	1,453,576
Liabilities									
Deposits by banks									

- repos	20,585	—		12,154			32,739
- other (3)	28,216	—		37,835			66,051
Customer accounts							
- repos	53,031	—		29,063			82,094
- other (4)	14,357	4,824		409,418			428,599
Debt securities in issue (5,6)	7,730	43,488		167,154			218,372
Settlement balances	—	—		10,991			10,991
Short positions	43,118	—					43,118
Derivatives	419,103		4,864				423,967
Accruals, deferred income and other liabilities	—	—		1,793	458	20,838	23,089
Retirement benefit liabilities						2,288	2,288
Deferred tax						2,142	2,142
Insurance liabilities						6,794	6,794
Subordinated liabilities	—	1,129		25,924			27,053
Liabilities of disposal groups						9,428	9,428
	586,140	49,441	4,864	694,332	458	41,490	1,376,725
Equity							76,851
							1,453,576

For notes relating to this table refer to page 244.

	Group								
2009	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	52,261				52,261
Loans and advances to banks									
- reverse repos	26,886	—		—	8,211				35,097
- other (1)	18,563	—		—	38,093				56,656
Loans and advances to customers									
- reverse repos	26,313	—		—	14,727				41,040
- other (2)	15,964	1,981		—	656,310		13,098		687,353
Debt securities	111,482	2,603		143,298	9,871				267,254
Equity shares	14,443	2,192		2,893	—				19,528
Settlement balances	—	—		—	12,033				12,033
Derivatives	436,857		4,597						441,454
Intangible assets								17,847	17,847
Property, plant and equipment								19,397	19,397
Deferred tax								7,039	7,039
Prepayments, accrued income and other assets	—	—		—	1,421			19,564	20,985
Assets of disposal groups								18,542	18,542
	650,508	6,776	4,597	146,191	792,927		13,098	82,389	1,696,486
Liabilities									
Deposits by banks									
- repos	20,962	—				17,044			38,006
- other (3)	32,647	—				71,491			104,138
Customer accounts									
- repos	41,520	—				26,833			68,353
- other (4)	11,348	8,580				525,921			545,849
Debt securities in issue (5,6)	3,925	41,537				222,106			267,568
Settlement balances	—	—				10,413			10,413
Short positions	40,463	—							40,463
Derivatives	417,634		6,507						424,141
	—	—				1,889	467	27,971	30,327

Accruals, deferred income and other liabilities							
Retirement benefit liabilities						2,963	2,963
Deferred tax						2,811	2,811
Insurance liabilities						10,281	10,281
Subordinated liabilities	—	1,277		36,375			37,652
Liabilities of disposal groups						18,890	18,890
	568,499	51,394	6,507	912,072	467	62,916	1,601,855
Equity							94,631
							1,696,486

For notes relating to this table refer to page 244.

11 Financial instruments - classification continued

	Group								
2008	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	Total £m
Assets									
Cash and balances at central banks	—	—		—	12,400				12,400
Loans and advances to banks									
- reverse repos	26,056	—		—	32,715				58,771
- other (1)	30,178	—		—	49,248				79,426
Loans and advances to customers									
- reverse repos	22,539	—		—	16,774				39,313
- other (2)	28,962	2,141		—	789,853		14,453		835,409
Debt securities	116,280	5,428		132,856	12,985				267,549
Equity shares	17,054	2,101		7,175	—				26,330
Settlement balances	—	—		—	17,832				17,832
Derivatives	985,700		6,859						992,559
Intangible assets								20,049	20,049
Property, plant and equipment								18,949	18,949
Deferred tax								7,082	7,082
Prepayments, accrued income and other assets	—	—		—	1,326			23,076	24,402
Assets of disposal groups								1,581	1,581
	1,226,769	9,670	6,859	140,031	933,133		14,453	70,737	2,401,652
Liabilities									
Deposits by banks									
- repos	43,196	—				40,470			83,666
- other (3)	37,958	—				136,420			174,378
Customer accounts									
- repos	39,942	—				18,201			58,143
- other (4)	15,984	8,054				557,331			581,369
Debt securities in issue (5,6)	3,992	47,451				248,846			300,289
Settlement balances	—	—				11,741			11,741
Short positions	42,536	—							42,536
Derivatives	963,088		8,276						971,364

Accruals, deferred income and other liabilities	260	—		1,619	22	29,581	31,482
Retirement benefit liabilities						2,032	2,032
Deferred tax						4,165	4,165
Insurance liabilities						9,976	9,976
Subordinated liabilities	—	1,509		47,645			49,154
Liabilities of disposal groups						859	859
	1,146,956	57,014	8,276	1,062,273	22	46,613	2,321,154
Equity							80,498
							2,401,652

For notes relating to this table refer to page 244.

Amounts included in the consolidated income statement:

	Group		
	2010	2009	2008
	£m	£m	£m
Gains/(losses) on financial assets/liabilities designated as at fair value through profit or loss	279	1,441	(901)
Gains/(losses) on disposal or settlement of loans and receivables	267	(573)	4

Notes:

(1) Includes items in the course of collection from other banks of £1,958 million (2009 - £2,533 million; 2008 - £2,888 million).

(2) The change in fair value of loans and advances to customers designated as at fair value through profit or loss attributable to changes in credit risk was £20 million charge for the year and cumulatively a credit of £82 million (2009 - release £157 million; cumulative £140 million credit; 2008 - £328 million charge; cumulative £440 million credit).

(3) Includes items in the course of transmission to other banks of £577 million (2009 - £770 million; 2008 - £542 million).

(4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £233 million lower (2009 - £101 million lower; 2008 - £47 million lower) than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial, measured as the change in fair value from movements in the period in the credit risk premium payable. The amounts include investment contracts with a carrying value of £41 million (2009 - £5,170 million; 2008 - £5,364 million).

(5) Comprises bonds and medium term notes of £154,282 million (2009 - £164,900 million; 2008 - £156,841 million) and certificates of deposit and other commercial paper of £64,090 million (2009 - £102,668 million; 2008 - £143,448 million).

(6) The carrying amount is £751 million (2009 - £810 million; 2008 - £1,145 million) lower than the principal amount.

(7) During 2009, the Group reclassified financial assets from the held-for-trading category into the loans and receivables category and in 2008 from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category (see pages 247 to 250).

11 Financial instruments - classification continued

The following tables analyse the company's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Company					
2010	Held-for-trading £m	Hedging derivatives £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Non financial assets/ liabilities £m	Total £m
Assets						
Loans and advances to banks (1)	—		19,535			19,535
Loans and advances to customers (2)	—		6,689			6,689
Debt securities (2)	—		1,454			1,454
Investments in Group undertakings					49,125	49,125
Derivatives (2)	1,223	252				1,475
Deferred tax					2	2
Prepayments, accrued income and other assets	—		—		28	28
	1,223	252	27,678	—	49,155	78,308
Liabilities						
Customer accounts (4)	—			1,029		1,029
Debt securities in issue	—			8,742		8,742
Derivatives (4)	231	—				231
Accruals, deferred income and other liabilities	—			—	1,034	1,034
Subordinated liabilities	—			8,048		8,048
	231	—		17,819	1,034	19,084
Equity						59,224
						78,308
2009						
Assets						
Loans and advances to banks (1)	—		31,238			31,238
Loans and advances to customers (2)	—		2,777			2,777
Debt securities (2)	—		1,286			1,286
Investments in Group undertakings					64,766	64,766
Settlement balances					11	11
Derivatives (2)	930	239				1,169
Deferred tax					2	2
Prepayments, accrued income and other assets	—		—		43	43
	930	239	35,301		64,822	101,292
Liabilities						
Deposits by banks (3)	—			93		93
Customer accounts (4)	—			13,264		13,264
Debt securities in issue	—			11,788		11,788

Derivatives (4)	432	14			446
Accruals, deferred income and other liabilities	—		—	1,357	1,357
Subordinated liabilities	—		8,762		8,762
	432	14	33,907	1,357	35,710
Equity					65,582
					101,292

For notes relating to this table refer to page 246.

11 Financial instruments - classification continued

The following tables analyse the company's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Company					
2008	Held-for-trading £m	Hedging derivatives £m	Loans and receivables £m	Other financial instruments (amortised cost) £m	Non financial assets/ liabilities £m	Total £m
Assets						
Loans and advances to banks (1)	—		27,031			27,031
Investments in Group undertakings					42,196	42,196
Derivatives (2)	975	193				1,168
Deferred tax					3	3
Prepayments, accrued income and other assets	—		—		489	489
	975	193	27,031		42,688	