

Pillar 3 Report 2013

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Forward-looking statements

This document contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of The Royal Bank of Scotland Group plc ('the Group'). Generally, words such as 'may', 'could', 'will', 'expect', 'intend', 'estimate', 'anticipate', 'believe', 'plan', 'seek', 'continue', 'project', 'should', 'probability', 'risk', 'value-at-risk', 'target', 'goal', 'objective', 'endeavour', 'outlook', 'optimistic' and 'prospects' or similar expressions or variations on such expressions identify forward-looking statements.

Any forward-looking statements set out herein represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. For further

risks and uncertainties faced by the Group that may impact the statements set out in this document, refer to the Group's 2013 Annual Report and Accounts and any other interim or updated information published by the Group.

Any forward-looking statements set out herein speak only as at the date of this document. Except as required by the Prudential Regulation Authority (PRA), the London Stock Exchange or other applicable law or regulation, the Group does not have any obligation to update or revise publicly any forward-looking statements, whether as a result of new information, further events or circumstances or otherwise, and expressly disclaims any obligation to do so.

Basis of disclosure

The Pillar 3 disclosures made by the Group are designed to comply with the PRA Handbook (Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) 11). They should be read in conjunction with the Group's 2013 Annual Report and Accounts, approved on 26 February 2014.

There are important differences between the Group's accounting disclosures and the disclosures required by the Capital Requirements Directive (CRD), which can be summarised as follows:

- The Basel II disclosures are presented on a regulatory, rather than an accounting basis of consolidation. Some businesses are included in the latter, but not in the former. Therefore, these disclosures may not be comparable to other external disclosures made by the Group.
- The definition of exposure differs between Basel II and International Financial Reporting Standards (IFRS). The Basel II definition used in the Pillar 3 disclosures is exposure at default rather than carrying value at the balance sheet date, as used in the Group's financial reporting.

It is not always possible to aggregate the disclosures across the different Basel II approaches to obtain a meaningful Group view. This is particularly relevant for the credit risk disclosures.

The information presented in this Pillar 3 Report is not required to be, and has not been, subject to external audit.

Whilst the Group has participated in discussions at the British Bankers' Association and other trade bodies, it is possible that disclosures made by other banks, especially outside the UK, are not directly comparable.

The Group has not omitted any disclosures on the grounds that the information may be proprietary or confidential.

Disclosures in relation to remuneration are included on pages 66 to 90 of the Group's 2013 Annual Report and Accounts.

Background

Regulatory framework

The Basel II framework was implemented in the European Union (EU) through the CRD.

The framework is based on three Pillars:

- **Pillar 1 - Minimum capital requirement:** defines rules for the calculation of credit, market and operational risk;
- **Pillar 2 - Supervisory review process:** requires banks to undertake an internal capital adequacy assessment process for risks not included in Pillar 1; and
- **Pillar 3 - Market discipline:** requires disclosures to allow investors and other market participants to understand the risk profiles of individual banks.

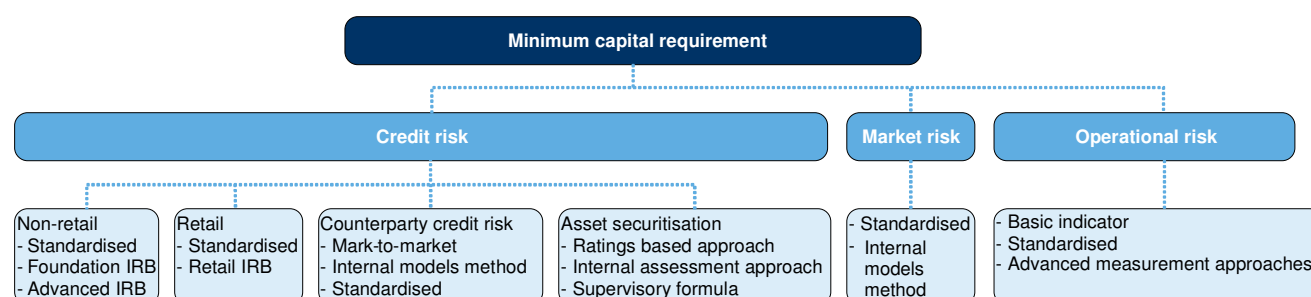
Banks are required to disclose their material risks as part of the Pillar 3 framework. Most of these requirements have already been satisfied within the Group's 2013 Annual Report and Accounts, available on the Group's website (rbs.com). The Group's 2013 Annual Report and Accounts includes a range of risk factors and provides in-depth analysis on the specific risks to which the Group is exposed.

These Pillar 3 disclosures provide additional information over and above that contained in the Group's 2013 Annual Report and Accounts.

Pillar 1 - Minimum capital requirement

Basel II requires risk-weighted assets (RWAs) to be calculated for credit, market and operational risks with various approaches available to banks, with differing levels of sophistication. The minimum capital requirement is calculated as 8% of RWAs.

Chart 1: Minimum capital requirement structure



Application in the Group

For credit risk, the majority of the Group uses the internal ratings based (IRB) approach for calculating RWAs. The standardised approach is used for exposures in certain portfolios.

The Group uses both standardised approach and internal models method for calculating market risk RWAs. Refer to pages 318 to 340 of the Group's 2013 Annual Report and Accounts for market risk disclosures, including minimum capital requirements and non-traded interest rate, currency and equity risks.

For operational risk, the Group uses the standardised approach to calculate RWAs based on gross income. Refer to pages 358 to 360 of the Group's 2013 Annual Report and Accounts for operational risk disclosures, including minimum capital requirements.

Background

Pillar 2 - Supervisory review process

Pillar 2 comprises the Group's internal capital adequacy assessment process (ICAAP) and a supervisory review and evaluation process undertaken on an annual basis and focusing on the amounts, types and distribution of capital which the Group considers adequate to cover the risks it is or may be exposed to.

The ICAAP evaluates capital requirements for major sources of risk over the short and long term:

- Pillar 2A comprises risks which are not captured in Pillar 1 (such as non-traded interest rate risk) or not adequately captured in Pillar 1 (such as credit concentration risk); and
- Pillar 2B incorporates stress testing and scenario analysis, which serve as a basis for a forward-looking assessment of the Group's capital requirements in stress and any resultant stress capital buffers.

The Group undertakes a risk assessment to ensure all material risks are identified, adequately managed and capitalised where appropriate.

Within Pillar 2A, the Group assesses credit concentration risk, certain aspects of traded market risk that are not fully captured in Pillar 1, non-traded interest rate risk (NTIRR), pension risk and operational risk to compensate for shortcomings of the Pillar 1 standardised approach. The Group uses economic capital models to estimate Pillar 2A capital charges for credit concentration and operational risk. A description of economic capital is provided on page 194 of the Group's 2013 Annual Report and Accounts. Information regarding specific credit risk concentrations, such as sector or geography, is included within Pillar 3. Refer to pages 334 and 335 of the Group's 2013 Annual Report and Accounts for more information on NTIRR and pages 356 and 357 for pension risk.

Pillar 2B is based on stress testing and scenario analysis. It is used to assess the quantum and quality of capital required to be set aside to counteract the adverse impact of a severe but plausible stress on the Group's capital, and to ensure capital levels in stress remain above minimum requirements.

The ICAAP is approved by the Group Board before it is submitted to the regulator and forms the basis of the supervisory review and the setting of the Individual Capital Guidance by the PRA.

Pillar 3 - Market discipline

The Group is committed to delivering best practice risk and capital disclosures, to ensure that stakeholders understand the risks within the Group. The Pillar 3 disclosures are designed to encourage and promote market transparency and stability. It represents a component of the Group's broader disclosures framework.

Group Internal Audit undertook an annual review to provide management and the Board with assurance relating to the adequacy and effectiveness of the controls over the production of the Pillar 3 disclosures.

The Group publishes its Pillar 3 disclosures on an annual basis as required by the CRD.

The Group's various subsidiaries in Europe publish capital and RWA data externally through an appropriate mechanism (such as websites and annual reporting statements), thereby satisfying the European Banking Authority requirements for disclosures in the member states. Outside the EU, local subsidiaries may make additional disclosures under Pillar 3, as required by their local regulators.

The Group continues to participate in the British Bankers' Association's drive towards consistent Pillar 3 disclosures for UK banks wherever possible. Footnotes are included with the data tables to ensure transparency regarding the approaches used for the disclosures. At EU and global levels, different definitions and assumptions adopted by other banks can make direct comparison difficult.

The Royal Bank of Scotland Group plc is the parent undertaking for all authorised firms in the Group and is subject to consolidated supervision by the PRA. The Pillar 3 disclosures have been prepared for the Group in accordance with BIPRU 11 of the PRA Handbook.

Regulatory and statutory consolidations Control

Inclusion of an entity in the statutory consolidation is driven by the Group's ability to exercise control over that entity. The regulatory consolidation applies a comparable test but consolidation is restricted to certain categories of entities. In accordance with PRA rules, non-financial and certain structured entities are excluded from the regulatory consolidation.

Significant influence or joint control

Where the Group does not have control of an entity but has more than 20% of the voting rights or capital of that entity, then it must be included in the regulatory consolidation on a pro-rata basis, unless it falls into one of the excluded categories or the Group has agreed a different treatment with the PRA (by obtaining a waiver). Such entities will only be included in the statutory consolidation on a pro-rata basis where the Group has joint control. Entities where the Group has significant influence will be equity accounted in the statutory consolidation.

Background

Solo-consolidation, impediments to the transfer of capital resources and aggregate capital deficiency

Individual firms within the Group apply the provisions in BIPRU 2.1 (solo-consolidation waiver) in a limited number of cases only. In 2013, The Royal Bank of Scotland plc had no solo-consolidated subsidiaries whilst National Westminster Bank Plc had three solo-consolidated subsidiaries. The waiver is only used where the business is an extension of the parent bank's activities undertaken through a subsidiary for commercial reasons and which requires solo-consolidation to ensure that there are no adverse consequences to the capital ratios.

The Group operates on an integrated basis with all Group companies being subject to policies, governance and controls that are set centrally. Aside from regulatory requirements, there are no current or foreseen material, practical or legal impediments to the transfer of capital or prompt repayments of liabilities when due.

There were no capital deficiencies (defined as the amount where the actual capital resources are less than the required minimum) in respect of subsidiaries not included in the Group consolidation.

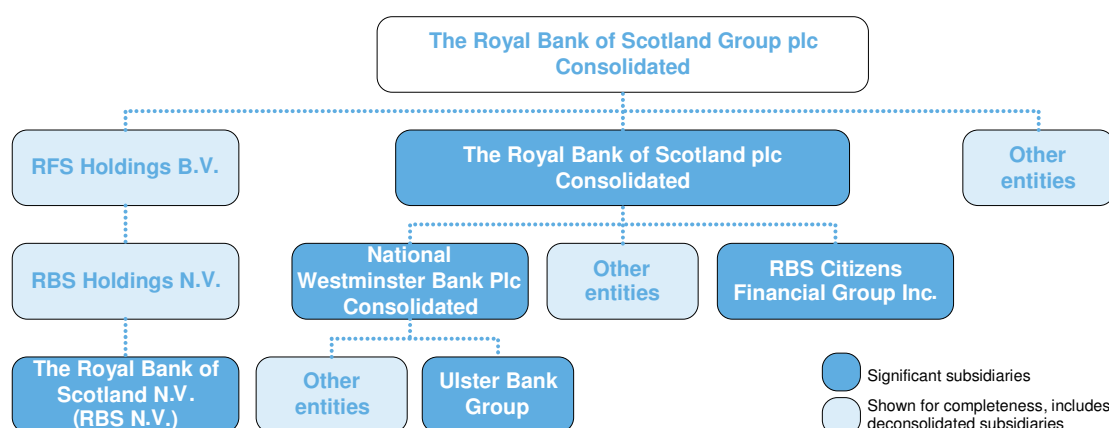
Risk governance and appetite

The Group is committed to the highest standards of corporate governance in every aspect of the business, including risk management. For further information refer to pages 176 and 177 of the Group's 2013 Annual Report and Accounts.

Risk appetite is an expression of the level of risk that the Group is prepared to accept in order to deliver its business objectives. For further information refer to pages 183 to 191 of the Group's 2013 Annual Report and Accounts.

Chart 2 represents a simplified regulatory hierarchy of the Group, specifically highlighting those subsidiaries and regions which are of significance. The Group has considered the requirements of the significant subsidiary disclosures and concluded that the following entities are within scope: The Royal Bank of Scotland plc Consolidated, National Westminster Bank Plc Consolidated, Ulster Bank Group, RBS N.V. and RBS Citizens Financial Group, Inc.

Chart 2: Regulatory Group hierarchy



Subsidiaries deconsolidated for regulatory reporting purposes include RBS Group Insurance Services Limited (excluding Lombard Direct Home Insurance Services Limited) and RBS Life Holdings Limited.

Capital

Group and significant subsidiaries

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 taken into account the supervisory requirements of the PRA.

The PRA uses the risk asset ratio (RAR) as one of the measures 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%.

At 31 December 2013, the Group's total RAR was 16.5% (2012 - 14.5%) and the Tier 1 RAR was 13.1% (2012 - 12.4%).

Capital allocation

Capital resources are allocated to the Group's businesses based on key performance parameters agreed by the Group Board in the annual strategic planning process. Principal among these is a profitability metric which assesses the effective use of the capital allocated to the business. Projected and actual return on equity is assessed against target returns set by the Group Board. The allocations also reflect strategic priorities and balance sheet and funding metrics.

Minimum capital requirement and RWAs

The following table details the Group's total RWAs and minimum capital requirement by risk type.

Table 1: Group RWAs and minimum capital requirements by risk type

Risk type	2013		2012	
	RWAs	Minimum capital requirement (1)	RWAs	Minimum capital requirement (1)
	£m	£m	£m	£m
Credit risk				
- non-counterparty	291,063	23,285	323,054	25,844
- counterparty	22,341	1,787	48,034	3,843
Market risk	30,242	2,419	42,625	3,410
Operational risk	41,809	3,345	45,853	3,668
	385,455	30,836	459,566	36,765

Note:

(1) Minimum capital requirement is defined as 8% of the RWAs.

Refer to pages 192 to 208 of the Group's 2013 Annual Report and Accounts for more information on:

- RWA analysis, movement tables and capital resources under current rules (Basel 2.5);

- Estimated RWA divisional analysis, capital resources and leverage ratios under the upcoming regulatory regime (CRD IV); and
- Regulatory developments.

Capital resources and RWA analyses in the rest of this report are based on CRD extent at 31 December 2013 and do not include disclosures under CRD IV which is effective on a phased basis from 1 January 2014.

Capital

Group and significant subsidiaries *continued*

The following tables show the minimum capital requirements and RWAs of the Group and its significant subsidiaries.

Table 2: Group minimum capital requirements

Risk type	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Credit risk						
- non-counterparty	23,285	22,222	7,572	2,366	1,036	4,188
- counterparty	1,787	1,797	221	31	53	40
Market risk	2,419	2,306	562	39	80	—
Operational risk	3,345	2,998	1,030	143	346	421
	30,836	29,323	9,385	2,579	1,515	4,649
2012						
Credit risk						
- non-counterparty	25,844	24,802	8,168	2,986	1,377	4,278
- counterparty	3,843	3,798	398	123	100	67
Market risk	3,410	3,141	830	12	224	—
Operational risk	3,668	3,308	1,148	162	346	426
	36,765	35,049	10,544	3,283	2,047	4,771

As highlighted by Chart 2 (Regulatory Group hierarchy), data for these five significant subsidiaries above do not aggregate to the overall Group position. Information for the Group is also included for comparison purposes.

Counterparty credit risk for RBS Consolidated at 31 December 2013 was higher than that of the Group as it included RWAs relating to intra-Group balances.

Capital

Table 3: RWAs by risk type

Risk type	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Credit risk						
- non-counterparty	291,063	277,781	94,646	29,578	12,942	52,349
- counterparty	22,341	22,464	2,767	381	664	494
Market risk	30,242	28,825	7,027	486	995	—
Operational risk	41,809	37,469	12,874	1,787	4,325	5,266
	385,455	366,539	117,314	32,232	18,926	58,109
2012						
Credit risk						
- non-counterparty	323,054	310,021	102,097	37,326	17,212	53,480
- counterparty	48,034	47,476	4,970	1,543	1,253	837
Market risk	42,625	39,268	10,379	153	2,804	—
Operational risk	45,853	41,355	14,350	2,019	4,321	5,328
	459,566	438,120	131,796	41,041	25,590	59,645

Table 4: Credit risk minimum capital requirements

Credit risk approach	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Non-counterparty						
- advanced IRB	16,205	15,362	6,386	2,332	574	—
- standardised	7,080	6,860	1,186	34	462	4,188
Counterparty	1,787	1,797	221	31	53	40
	25,072	24,019	7,793	2,397	1,089	4,228
2012						
Non-counterparty						
- advanced IRB	18,451	17,419	7,045	2,950	808	—
- standardised	7,393	7,383	1,122	36	569	4,278
Counterparty	3,843	3,798	398	123	100	67
	29,687	28,600	8,565	3,109	1,477	4,345

Note:

(1) Credit risk capital requirements include both intra-Group and non-credit assets.

Capital

Group and significant subsidiaries *continued*

Table 5: Non-counterparty credit risk IRB minimum capital requirements

Advanced IRB exposure class and sub-class	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m
2013					
Central governments and banks	323	182	10	8	139
Institutions	499	393	62	6	104
Corporates	10,391	9,933	3,083	737	246
Retail					
Small and medium-sized enterprises (SMEs)	540	540	395	113	—
secured by real estate collateral	2,447	2,447	1,936	1,371	—
qualifying revolving retail	721	721	513	46	—
other retail	454	454	320	24	—
	4,162	4,162	3,164	1,554	—
Equities					
exchange-traded	143	48	2	—	—
private equity	22	21	—	—	—
other	84	65	15	2	63
	249	134	17	2	63
Securitisation positions	269	245	—	—	22
Non-credit obligation assets	312	313	50	25	—
	16,205	15,362	6,386	2,332	574
2012					
Central governments and banks	539	375	8	2	155
Institutions	553	438	73	7	115
Corporates	11,492	10,848	3,358	1,165	488
Retail					
SMEs	639	639	504	162	—
secured by real estate collateral	2,559	2,559	1,992	1,433	—
qualifying revolving retail	763	763	539	67	—
other retail	506	506	357	28	—
	4,467	4,467	3,392	1,690	—
Equities					
exchange-traded	147	92	2	—	5
private equity	63	25	6	2	30
other	72	57	7	—	15
	282	174	15	2	50
Securitisation positions	480	477	—	—	—
Non-credit obligation assets	638	640	199	84	—
	18,451	17,419	7,045	2,950	808

Note:

(1) RBS Citizens Financial Group is not included as it is wholly on the Basel II standardised approach.

Capital

Table 6: Non-counterparty credit risk STD minimum capital requirements

Standardised exposure class	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Regional governments or local authorities	5	4	1	—	1	1
Administrative bodies and non-commercial undertakings	1	1	—	—	—	1
Institutions	50	238	27	—	16	5
Covered bonds	1	1	1	—	—	—
Collective investment undertakings	2	2	2	—	—	—
Corporates	3,826	3,486	330	10	353	2,394
Retail	1,313	1,286	127	7	27	995
Secured by mortgages on						
- commercial real estate	340	340	148	—	—	163
- residential property	613	593	179	—	20	317
Past due items	120	120	30	17	—	68
Securitisation positions	32	32	—	—	—	32
Other items	777	757	341	—	45	212
	7,080	6,860	1,186	34	462	4,188
2012						
Regional governments or local authorities	7	4	—	—	3	1
Administrative bodies and non-commercial undertakings	1	1	—	—	—	1
Institutions	84	501	36	—	16	4
Corporates	3,809	3,488	360	10	353	2,189
Retail	1,517	1,475	151	8	43	1,143
Secured by mortgages on						
- commercial real estate	557	574	182	—	12	283
- residential property	585	547	128	—	11	374
Past due items	174	164	28	17	10	55
Securitisation positions	21	21	—	—	—	21
Other items	638	608	237	1	121	207
	7,393	7,383	1,122	36	569	4,278

Table 7: Counterparty credit risk requirements

	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Counterparty credit risk	1,787	1,797	221	31	53	40
2012						
Counterparty credit risk	3,843	3,798	398	123	100	67

Standardised exposures for institutions and corporates within RBS Consolidated were higher than Group as it included RWAs relating to intra-Group balances.

Capital

Group and significant subsidiaries *continued*

Table 8: Market risk trading book and other business minimum capital requirements

	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m
2013					
Interest rate position risk requirement	147	122	23	10	1
Equity position risk requirement	1	1	—	—	—
Option position risk requirement	10	1	—	—	—
Specific interest rate risk of securitisation positions	123	123	35	—	—
Commodity position risk requirement	13	13	2	—	—
Foreign exchange position risk requirement	39	37	32	29	2
Total (standard method)	333	297	92	39	3
Pillar 1 model based position risk requirement	2,086	2,009	470	—	77
Total position risk requirement	2,419	2,306	562	39	80

The contributors to the Pillar 1 model based position risk requirement are:

Value-at-risk (VaR)	576	563	70	—	13
Stressed VaR	841	789	229	—	52
Incremental risk charge	443	431	108	—	12
All price risk	8	8	—	—	—
Risks not in VaR	218	218	63	—	—

2012

Interest rate position risk requirement	254	224	39	8	2
Equity position risk requirement	1	1	1	—	—
Option position risk requirement	26	9	—	—	—
Specific interest rate risk of securitisation positions	156	156	54	—	—
Commodity position risk requirement	2	2	2	—	—
Foreign exchange position risk requirement	12	10	10	4	2
Total (standard method)	451	402	106	12	4
Pillar 1 model based position risk requirement	2,959	2,739	724	—	220
Total position risk requirement	3,410	3,141	830	12	224

The contributors to the Pillar 1 model based position risk requirement are:

VaR	825	793	120	—	32
Stressed VaR	1,226	1,115	289	—	111
Incremental risk charge	467	390	131	—	77
All price risk	12	12	—	—	—
Risks not in VaR	429	429	184	—	—

Capital

Table 9: Capital resources

	2013					
	Group	RBS	NatWest	Ulster Bank	RBS N.V. (1)	RBS Citizens Financial Group (2)
	£m	£m	£m	£m	£m	£m
Shareholders' equity (excluding non-controlling interests)						
Shareholders' equity	58,742	48,786	12,872	3,615	2,450	11,604
Preference shares - equity	(4,313)	—	—	(959)	—	—
Other equity instruments	(979)	(1,421)	—	—	—	—
	53,450	47,365	12,872	2,656	2,450	11,604
Non-controlling interests						
Non-controlling interests	473	79	1,278	517	—	—
Non-controlling preference shares	—	—	(1,174)	—	—	—
Regulatory adjustments to non-controlling interests	—	—	—	(487)	—	—
	473	79	104	30	—	—
Regulatory adjustments and deductions						
Own credit	726	1,519	—	—	(191)	—
Defined benefit pension fund adjustment	362	362	532	105	—	—
Net unrealised available-for-sale (AFS) losses/(gains)	308	(359)	(55)	—	734	55
Cash flow hedging reserve	84	86	6	—	1	337
Other regulatory adjustments	(103)	50	54	—	(1)	323
Goodwill and other intangible assets	(12,368)	(12,352)	(797)	—	(1)	(4,273)
50% of expected losses less impairment provisions (net of tax)	(19)	(54)	(52)	—	(2)	—
50% of securitisation positions	(748)	(722)	(231)	—	(24)	—
	(11,758)	(11,470)	(543)	105	516	(3,558)
Core Tier 1 capital	42,165	35,974	12,433	2,791	2,966	8,046
Other Tier 1 capital						
Preference shares - equity	4,313	—	—	1,446	1,969	—
Preference shares - debt	911	2,745	283	—	—	—
Non-controlling preference shares	—	—	1,174	—	—	—
Innovative/hybrid Tier 1 securities	4,207	3,502	—	—	(357)	—
	9,431	6,247	1,457	1,446	1,612	—
Tier 1 deductions						
50% of material holdings	(976)	(409)	(418)	(14)	(1,214)	—
Tax on expected losses less impairment provisions	6	16	15	—	—	—
Other regulatory adjustments	—	—	—	—	(1)	(5)
	(970)	(393)	(403)	(14)	(1,215)	(5)
Total Tier 1 capital	50,626	41,828	13,487	4,223	3,363	8,041

For the notes to this table refer to page 16.

Capital

Group and significant subsidiaries *continued*

Table 9: Capital resources *continued*

	2013					
	Group	RBS Consolidated	NatWest Consolidated	Ulster Bank Group	RBS N.V. (1)	RBS Citizens Financial Group (2)
	£m	£m	£m	£m	£m	£m
Qualifying Tier 2 capital						
Undated subordinated debt	2,109	4,716	2,226	100	357	—
Dated subordinated debt - net of amortisation	12,436	18,371	4,480	972	1,293	816
Unrealised gains on AFS equity shares	114	111	59	—	2	1
Collectively assessed impairment provisions	395	375	1	—	—	745
Surplus provisions	—	—	—	175	—	—
	15,054	23,573	6,766	1,247	1,652	1,562
Tier 2 deductions						
50% of securitisation positions	(748)	(722)	(231)	—	(24)	—
50% of standardised expected losses less impairment provisions	(25)	(70)	(67)	—	(2)	—
50% of material holdings	(976)	(409)	(418)	(14)	(1,214)	—
Other regulatory adjustments	—	—	—	—	—	—
	(1,749)	(1,201)	(716)	(14)	(1,240)	—
Total Tier 2 capital	13,305	22,372	6,050	1,233	412	1,562
Supervisory deductions						
Unconsolidated investments	(36)	(36)	—	—	—	—
Other deductions	(236)	(217)	(56)	—	—	—
	(272)	(253)	(56)	—	—	—
Total regulatory capital	63,659	63,947	19,481	5,456	3,775	9,603

For the notes to this table refer to page 16.

In Ulster Bank Group, surplus provision is allowable within Tier 2 capital as advanced IRB (AIRB) provisions exceeded expected loss at 31 December 2013.

Capital

Table 9: Capital resources *continued*

	2012					
	Group	RBS	NatWest	Ulster Bank	RBS N.V. (1)	RBS Citizens Financial Group (2)
	£m	£m	£m	£m	£m	£m
Shareholders' equity (excluding non-controlling interests)						
Shareholders' equity	68,678	59,288	20,700	6,894	1,467	14,928
Preference shares - equity	(4,313)	—	—	(959)	—	—
Other equity instruments	(979)	(1,421)	—	—	—	—
	63,386	57,867	20,700	5,935	1,467	14,928
Non-controlling interests						
Non-controlling interests	1,770	137	1,257	500	—	—
Non-controlling preference shares	—	—	(1,164)	—	—	—
Regulatory adjustments to non-controlling interests	(1,367)	—	—	(477)	—	—
	403	137	93	23	—	—
Regulatory adjustments and deductions						
Own credit	691	1,563	—	—	(285)	—
Defined benefit pension fund adjustment	913	913	—	(82)	—	—
Net unrealised AFS losses/(gains)	346	(1,750)	(21)	—	2,016	(189)
Cash flow hedging reserve	(1,666)	(1,815)	10	—	1	382
Other regulatory adjustments	(197)	10	(165)	—	(30)	—
Goodwill and other intangible assets	(13,545)	(12,403)	(736)	—	(3)	(6,609)
50% of expected losses less impairment provisions	(1,904)	(1,954)	(1,407)	(1,088)	(17)	—
50% of securitisation positions	(1,107)	(1,001)	(331)	—	(40)	—
	(16,469)	(16,437)	(2,650)	(1,170)	1,642	(6,416)
Core Tier 1 capital	47,320	41,567	18,143	4,788	3,109	8,512
Other Tier 1 capital						
Preference shares - equity	4,313	—	—	1,436	2,014	179
Preference shares - debt	1,054	2,759	286	—	—	—
Non-controlling preference shares	—	—	1,164	—	—	—
Innovative/hybrid Tier 1 securities	4,125	3,551	—	—	(308)	—
	9,492	6,310	1,450	1,436	1,706	179
Tier 1 deductions						
50% of material holdings	(295)	(239)	(387)	—	(1,129)	—
Tax on expected losses less impairment provisions	618	634	457	353	—	—
Other regulatory adjustments	—	—	—	(314)	—	(8)
	323	395	70	39	(1,129)	(8)
Total Tier 1 capital	57,135	48,272	19,663	6,263	3,686	8,683

For the notes to this table refer to page 16.

Capital

Group and significant subsidiaries *continued*

Table 9: Capital resources *continued*

	2012					
	Group	RBS	NatWest	Ulster Bank	RBS N.V. (1)	RBS Citizens Financial Group (2)
	£m	£m	£m	£m	£m	£m
Qualifying Tier 2 capital						
Undated subordinated debt	2,194	4,814	2,265	98	308	—
Dated subordinated debt - net of amortisation	13,420	18,121	4,612	1,029	2,624	217
Unrealised gains on AFS equity shares	63	40	23	—	15	1
Collectively assessed impairment provisions	399	379	—	—	—	764
	16,076	23,354	6,900	1,127	2,947	982
Tier 2 deductions						
50% of securitisation positions	(1,107)	(1,001)	(331)	—	(40)	—
50% of standardised expected losses less impairment provisions	(2,522)	(2,588)	(1,864)	(1,441)	(17)	—
50% of material holdings	(295)	(239)	(387)	—	(1,129)	—
Other regulatory adjustments	—	—	—	314	(188)	—
	(3,924)	(3,828)	(2,582)	(1,127)	(1,374)	—
Total Tier 2 capital	12,152	19,526	4,318	—	1,573	982
Supervisory deductions						
Unconsolidated investments	(2,243)	(37)	—	—	—	—
Other deductions	(244)	(193)	(56)	—	—	—
	(2,487)	(230)	(56)	—	—	—
Total regulatory capital	66,800	67,568	23,925	6,263	5,259	9,665

Notes:

(1) RBS N.V. disclosure is based on De Nederlandsche Bank (DNB) disclosure, with specific national discretions applied by DNB.

(2) Based on FED Band 1 which does not incorporate a Core Tier 1 definition. The above amount shows value for Core Tier 1.

Capital

Table 10: Capital instruments

The following table details the main terms and conditions of the Group's capital instruments treated as Tier 1 capital under Pillar 1, or Tier 2 capital which includes an incentive for the issuer to redeem. The balances are the IFRS balance sheet carrying amounts, which may differ from the amount which the instrument contributes to regulatory capital. Regulatory balances exclude, for example, issuance costs and fair value movements, while dated capital is required to be amortised on a straight-line basis over the final five years of maturity. For accounting purposes the capital instruments in the following table are included within equity or subordinated liabilities, details of which are included on pages 454 to 464 of the Group's 2013 Annual Report and Accounts.

	Step-up coupon	2013 £m	2012 £m
Pillar 1 treatment - Tier 1			
RBSG - undated loan capital			
US\$762 million 7.648% perpetual regulatory (callable quarterly from September 2031)	3 month US\$ LIBOR plus 2.5%	465	477
RBSG - debt preference shares			
Series F US\$156 million 7.65% (callable any time from March 2007)		95	97
Series H US\$242 million 7.25% (callable any time from March 2004)		146	150
Series L US\$751 million 5.75% (callable any time from October 2009)		454	465
Series 1 US\$65 million 9.118% (callable any time from March 2010)		40	41
Series 1 £15 million 7.387% (callable any time from December 2010)		15	15
NatWest Plc - debt preference shares			
Series A £140 million 9% (not callable)		143	145
Series C US\$246 million 7.7628% (callable quarterly from April 2002)		145	161
RBS US Capital Trusts - debt trust preferred securities			
€391 million floating rate 2042 (callable quarterly from June 2012)	3 month EURIBOR plus 2.1%	326	319
US\$486 million 6.8% 2042 (callable quarterly from March 2008)		294	302
US\$318 million floating rate 2043 (callable quarterly from July 2013)	3 month US\$ LIBOR plus 1.865%	192	199
US\$394 million 6.425% 2043 (callable quarterly from January 2034)	3 month US\$ LIBOR plus 1.9425%	301	365
RBS NV US Capital Trusts - debt trust preferred securities			
US\$1,285 million 5.90% Trust Preferred V (callable any time from July 2008)		730	713
US\$200 million 6.25% Trust Preferred VI (callable any time from September 2008)		114	112
US\$1,800 million 6.08% Trust Preferred VII (callable any time from February 2009)		1,020	999
RBS US Capital Trusts - equity trust preferred securities			
US\$357 million 5.512% (redeemable September 2014)	3 month US\$ LIBOR plus 1.84%	195	195
US\$276 million 3 month US\$ LIBOR plus 0.80% (redeemable September 2014)	3 month US\$ LIBOR plus 1.8%	150	150
€166 million 4.243% (redeemable January 2016)	3 month EURIBOR plus 1.69%	110	110
£93 million 5.6457% (redeemable June 2017)	3 month LIBOR plus 1.69%	93	93
RBSG - paid in equity trades			
CAD321 million 6.666% (callable quarterly from October 2017)	3 month CDOR plus 2.76%	156	156
US\$564 million 6.99% (callable quarterly from October 2017)	3 month US\$ LIBOR plus 2.67%	275	275

Capital

Group and significant subsidiaries *continued*

Table 10: Capital instruments *continued*

	Step-up coupon	2013 £m	2012 £m
Pillar 1 treatment - Tier 1 <i>continued</i>			
RBSG - equity preference shares			
Series M US\$578 million 6.4% (callable any time from September 2009)		313	313
Series N US\$553 million 6.35% (callable any time from June 2010)		292	292
Series P US\$247 million 6.25% (callable any time from December 2010)		138	138
Series Q US\$516 million 6.75% (callable any time from June 2011)		268	268
Series R US\$254 million 6.125% (callable any time from December 2011)		126	126
Series S US\$661 million 6.6% (callable any time from June 2012)		321	321
Series T US\$1,281 million 7.25% (callable any time from December 2012)		615	615
Series U US\$1,013 million 7.64% (callable every ten years from September 2017)	3 month US\$ LIBOR plus 2.32%	494	494
Series 1 €1,250 million 5.5% (callable quarterly from December 2009)		859	859
Series 2 €785 million 5.25% (callable quarterly from June 2010)		512	512
Series 3 €471 million 7.0916% (callable quarterly from September 2017)	3 month EURIBOR plus 2.33%	325	325
Series 1 £54 million floating rate notes (callable quarterly from October 2012)	3 month LIBOR plus 2.33%	54	54
Tier 2 capital securities which contain an incentive for the issuer to redeem			
Pillar 1 treatment - Upper Tier 2			
RBS plc - undated loan capital			
£1 million floating rate undated subordinated notes (callable semi-annually from March 2011)	6 month LIBOR plus 0.75%	1	1
£176 million 5.125% undated subordinated notes (callable quarterly from July 2014)	3 month EURIBOR plus 1.65%	153	155
£170 million floating rate undated subordinated notes (callable quarterly from July 2014)	3 month EURIBOR plus 1.60%	141	138
£56 million 6% undated subordinated notes (callable every five years from September 2014)	Aggregate of 1.85% and the 5 year UK Gilts yield	59	61
£54 million 5.125% undated subordinated notes (callable every five years from March 2016)	Aggregate of 1.95% and the 5 year UK Gilts yield	60	61
CAD474 million 5.37% undated subordinated notes (callable quarterly from May 2016)	3 month CDOR plus 1.48%	291	328
£51 million floating rate undated subordinated notes (callable every five years from December 2012)	Aggregate of 2.35% and the 5 year UK Gilts yield	50	51
£103 million 9.5% undated subordinated bonds (callable every five years from August 2018)	9.5% or the 5 year UK Gilts yield plus 2.375%	127	137
£35 million 5.5% undated subordinated notes (callable every five years from December 2019)	Aggregate of 1.84% and the 5 year UK Gilts yield	39	39
£21 million 6.2% undated subordinated notes (callable every five years from March 2022)	Aggregate of 2.05% and the 5 year UK Gilts yield	26	46
£16 million 5.625% undated subordinated notes (callable every five years from September 2026)	Aggregate of 2.10% and the 5 year UK Gilts yield	24	24
£19 million 5.625% undated subordinated notes (callable every five years from June 2032)	Aggregate of 2.41% and the 5 year UK Gilts yield	21	13
NatWest Plc - undated loan capital			
£10 million floating rate undated step-up notes (callable quarterly from October 2009)	3 month EURIBOR plus 2.15%	9	9
£178 million floating rate undated subordinated notes (callable quarterly from October 2009)	3 month EURIBOR plus 2.15%	149	146
£87 million floating undated subordinated step-up notes (callable every five years from January 2010)	5 year UK Gilts yield plus 2.98%	92	92
£53 million 7.125% undated subordinated step-up notes (callable every five years from October 2022)	5 year UK Gilts yield plus 3.08%	54	55

Capital

Table 10: Capital instruments *continued*

	Step-up coupon	2013 £m	2012 £m
Tier 2 capital securities which contain an incentive for the issuer to redeem <i>continued</i>			
Pillar 1 treatment - Lower Tier 2			
RBS plc - dated loan capital			
AUD90 million floating rate subordinated notes 2017 (callable quarterly from February 2012)	3 month BBSW plus 0.78%	49	58
CAD217 million floating rate subordinated notes 2015 (callable quarterly from March 2010)	3 month CDOR plus 0.72%	123	135
US\$686 million floating rate subordinated notes 2016 (callable quarterly from April 2011)	3 month US\$ LIBOR plus 0.7%	415	425
US\$229 million floating rate subordinated notes 2016 (callable quarterly from October 2011)	3 month US\$ LIBOR plus 0.78%	139	142
€227 million floating rate subordinated notes 2016 (callable quarterly from January 2011)	3 month EURIBOR plus 0.85%	189	185
€102 million floating rate subordinated notes 2017 (callable quarterly from January 2012)	3 month EURIBOR plus 0.75%	85	84
AUD265 million floating rate subordinated notes 2014 (callable quarterly from October 2009)	3 month BBSW plus 0.87%	144	171
AUD397 million floating rate subordinated notes 2014 (callable quarterly from October 2009)	3 month BBSW plus 0.87%	216	257
AUD50 million floating rate subordinated notes 2017 (callable quarterly from February 2012)	3 month BBSW plus 0.78%	27	32
US\$450 million floating rate subordinated step-up notes 2017 (callable quarterly from August 2012)	3 month US\$ LIBOR plus 0.7%	272	279
CHF34 million floating rate subordinated notes 2017 (callable quarterly from December 2012)	3 month CHF LIBOR plus 0.62%	23	23
€1,000 million 4.625% subordinated notes 2021 (callable quarterly from September 2016)	3 month EURIBOR plus 1.3%	925	938
US\$322 million floating rate Bermudan callable subordinated notes 2015 (callable quarterly from September 2010)	3 month US\$ LIBOR plus 0.74%	195	199
First Active plc - dated loan capital			
£60 million floating rate subordinated bonds 2018 (callable quarterly from April 2013)	3 month LIBOR plus 2.54%	60	63
RBS N.V. - dated loan capital			
€5 million floating rate Bermudan callable subordinated notes 2015 (callable quarterly from October 2010)	3 month EURIBOR plus 1.5%	4	4
AUD175 million floating rate Bermudan callable subordinated notes 2018 (callable quarterly from May 2013)	3 month BBSW plus 0.79%	93	109
AUD575 million floating rate Bermudan callable subordinated notes 2018 (callable quarterly from May 2013)	3 month BBSW plus 0.79%	305	366
\$564 million (2012 - US\$1,500 million) floating rate Bermudan subordinated notes 2015 (callable quarterly from March 2010, partial redemption 2013)	3 month US\$ LIBOR plus 0.7%	340	892
€415 million (2012 - €1,500 million) floating rate Bermudan subordinated notes 2015 (callable quarterly from June 2010, partial redemption 2013)	3 month EURIBOR plus 0.75%	344	1,215
€100 million 5.13% flip flop Bermudan callable subordinated notes 2017 (redeemed July 2013)	3 month EURIBOR plus 0.94%	—	72

Credit risk

Credit risk is the risk of financial loss owing to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts.

The Group is exposed to credit risk as a result of a wide range of business activities. The most significant source of credit risk is lending. The second most significant source is counterparty credit risk, which results from the Group's activities in the derivatives and security financing transaction markets. The Group's credit risk management framework addresses not only credit risk but also concentration risk, settlement risk, issuer risk, wrong way risk and credit mitigation risk.

Credit risk management

Information on how the Group manages credit risk is detailed on pages 227 to 267 of the Group's 2013 Annual Report and Accounts.

Measurement of credit RWAs under Basel II

The Group has been granted permission by the PRA to use the IRB approach to calculate RWAs for the majority of its credit risk exposures. This approach allows the Group to use its own models to estimate probability of default (PD), loss given default (LGD) and exposure at default (EAD) as inputs to the regulatory formula that determines RWAs.

In the case of project finance and income-producing real estate, the supervisory slotting approach rather than the Group's internally modelled estimates is used to determine RWAs.

For some portfolios, primarily in US Retail & Commercial and Wealth, the Group applies the STD approach. Exposures are allocated to exposure classes in accordance with the regulatory requirements. Under this approach, the Group uses credit ratings from external rating agencies (Standard & Poor's (S&P), Moody's and Fitch) to assign exposures to corporates, sovereigns and financial institutions to credit quality steps, as defined by the regulation.

Refer to Table 14 for an analysis of approach by division.

Credit risk models

The Group uses credit risk models to support risk assessments in the credit approval process, ongoing credit risk management, monitoring and reporting, as well as the calculation of RWAs.

Probability of default/customer credit grade models

PD models assess the probability of a customer failing to honour its credit obligations over a one year period.

Wholesale models

- As part of the credit assessment process, the Group assigns each customer a credit grade reflecting its PD. The Group maintains and uses a number of credit grading models which consider risk characteristics relevant to the customer, incorporating both quantitative and qualitative inputs. The Group uses these credit grades in many of its risk management and measurement frameworks, including credit sanctioning and managing single name concentration risk.

- Different models are developed for different customer types. The most material models (those used for the largest aggregate amounts of exposure) are those applied to large and mid-corporate customers and bank and sovereign counterparties. In addition, a number of less material models are used, including those for non-bank financial institutions, public sector entities and specialist corporate sectors such as shipping.
- Regulation defines the minimum time series and other attributes of the data used for developing and calibrating models. For the most material models, external data are referenced for calibration purposes (historical default data from rating agencies and insolvency rates) so that models are calibrated to in excess of 20 years of default experience. Most of the less material models relate to portfolios for which default frequency is low because customer loan volumes are lower and borrowers are of higher credit quality. In these cases, as required by regulation, a specific approach is applied to produce an appropriately prudent calibration to reflect the potential that future outcomes differ from the very low risk outcomes historically observed.

Retail models

- The Group assigns each customer account a score, which is a typical input into the model used to assign a PD. Account scoring is used extensively across the businesses to support decision making and portfolio management. Models are developed using a range of data across portfolios, including both customer and account data as well as data from credit bureaux.
- Different models are developed for different product types, with further distinctions based on other criteria, such as whether or not a customer also has a current account with the Group. All retail PD models produce both a best estimate measure, which is used for portfolio reporting and forecasting, and a conservative measure, which is required as input to the RWA and provision calculations. The conservative measure is designed to be a PD that takes account of the normal volatility observed in actual default rates. PDs are calibrated quarterly to ensure that they continue to reflect the actual underlying portfolio performance.

Exposure at default models

EAD models provide estimates of utilisation of a credit facility at the time of a customer's default, recognising that customers may make further drawings on unused credit facilities prior to default. Regulation requires that EAD is always equal to or higher than current utilisation. Exposure can be reduced by a netting agreement, subject to meeting standards of legal enforceability.

Different wholesale and retail models are developed for different product types. Models are developed using internal data as stipulated by regulatory requirements. The models with greatest impact on EAD are those applying to revolving products (such as revolving credit facilities granted to wholesale customers, credit cards provided to retail customers or overdraft facilities provided to all customer types). For these products, historical data on limit utilisation in the period prior to customer default are used to estimate and calibrate the models. In line with regulatory requirements, the model estimates reflect downturn conditions.

Credit risk

Loss given default models

LGD models estimate the amount that cannot be recovered by the Group in the event of customer default. When estimating LGD, the Group's models assess both borrower and facility characteristics, as well as various credit risk mitigants (refer to Table 19 for more information). The cost of collections and the timing of recoveries are also incorporated.

Wholesale models

- Different models are developed for different customer segments and reflect the recoveries approach applied to each segment. A number of the most material models are being updated across the group.
- The majority of the most material models (for large corporates, sovereigns and banks) reflect both internal and external loss experience, while the revised model for mid-corporates reflects internal loss experience only. The risk drivers in these models include: seniority of claim; the existence and nature of collateral held; industry segment; and customer size.
- Models also reflect updated regulatory requirements, including floors on estimates where historical data is scarce.

Retail models

- Different models are developed for different product types. They are based on internal loss data reflecting the Group's collections and recoveries processes.

In line with regulatory requirements, the model estimates reflect downturn conditions.

Modelling framework (including back-testing)

Credit risk models are developed and maintained within a framework that includes the following key components:

- A high level policy framework that establishes responsibilities and minimum requirements applying to each stage of the modelling lifecycle:
 - Data sourcing and preparation;
 - Model specification;
 - Model review;
 - Model approval;
 - Model implementation; and
 - Model maintenance - monitoring and annual review.
- Detailed standards that define the approaches and activities undertaken at each of these stages.
- Defined structure and authorities that approve or oversee each stage.
- Model development teams that are part of the independent risk management function.
- An independent model validation function - Group Risk Analytics - that is organisationally separate from the model development teams.

The framework aims to ensure that the Group is not exposed to excessive model risk and that the approaches deployed continue to meet both internal and regulatory standards.

The performance of models is tested by quarterly monitoring and annual reviews.

Each quarter, every model is tested by comparing estimates to outcomes to assess the accuracy of model parameters. Other statistical tests assess the ability of the models to discriminate risk (i.e. their ability to determine the relative risk level of a particular customer or exposure), the extent to which portfolio composition remains stable and, where relevant, the frequency and severity of overrides applied by model users to modelled estimates.

The annual reviews comprise further analyses that considers:

- ongoing user acceptance and confidence in the model and its performance;
- developments in the portfolio (both observed and anticipated); and
- other relevant data that might be used to explain or assess model performance.

Where model performance or another aspect of model risk is determined to be outside tolerance as part of the quarterly monitoring or annual review, remediation takes place. This may entail recalibrating the model, enhancing it (such as by re-weighting existing model factors) or redeveloping it.

Changes to wholesale credit risk models

Extensive changes were made to wholesale models in 2012 and 2013. This process is ongoing, with further changes, notably in the case of models used for the banks and corporate exposure classes, planned for 2014. For a quantitative analysis of the key drivers of the movement in credit risk RWAs during 2013, refer to page 202 of the Group's 2013 Annual Report and Accounts.

As in 2012, the impact of the model changes implemented in 2013 largely affected the lower risk segments of the Group's portfolios, relating to customers bearing the equivalent of investment-grade ratings.

Adjustments to RWAs were made with the agreement of the Group's regulators in anticipation of the changes. As a result, the actual implementation of updated models had only a modest impact on RWAs in 2013, and this will remain the case in 2014. Where relevant, the Group has also anticipated the impact of model changes in its risk frameworks, including risk appetite.

The transition of income-producing real estate assets to the supervisory slotting approach for the purposes of calculating RWAs had largely been carried out by the end of 2013. Given that the transition is nearly complete and internal models are no longer used to determine RWAs for these exposures, Tables 34 and 35 no longer incorporate data on the performance and back-testing of the internal models used for these exposures.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, commentary has been differentiated between instances where movements in risk measures reflect the impact of model changes and those that reflect movements in the size of underlying credit portfolios or their credit quality.

Credit risk

Overview of credit risk tables

Distinction between counterparty and non-counterparty risk

Credit risk exposures are split between counterparty and non-counterparty risk. Counterparty credit risk principally comprises exposures arising from over-the-counter (OTC) derivatives and securities financing transactions. Non-counterparty credit risk excludes exposures arising from OTC derivatives and securities financing transactions, but includes loans and advances to customers, banks and central banks, as well as holdings of debt and equity securities.

Distinction between sector clusters and regulatory exposure classes

Two principal classifications are used to analyse credit risk exposures in this section:

- **Sector cluster** - Consists of exposures classified by industry using standard industrial classification codes. The Group uses this type of classification for internal risk management purposes.
- **Exposure class** - Consists of exposures classified in accordance with BIPRU, namely regulation 4.3.2 for the IRB approach and regulation 3.2.9 for the STD approach. The Group uses this type of classification when calculating its regulatory capital requirements.

The following summarises the organisational structure of the credit risk tables:

	Total credit risk (non-counterparty and counterparty combined)	Non-counterparty credit risk only	Counterparty credit risk only
Sector cluster view	Tables 11 to 13		
Exposure class view vs. divisional view	Table 14		
Exposure class view vs. sector cluster view		Table 16	
Exposure class view	Table 15	Tables 17 to 35	Tables 36 to 38

Tables 11 to 18 include the following categories of exposure:

- **non-credit assets** - assets owned by the Group without associated credit risk or uncertainty related to obligor performance affecting their future value. These comprise tangible assets (such as property, plant and equipment), prepayments, accrued income, items in transit and deferred tax assets;
- **consortium investment exposures** - exposures arising as a result of equity investments made by the Group in its capacity as a member of a consortium; and
- **intra-Group exposures** - exposures to Group entities excluded from the regulatory consolidation.

These items are allocated across exposure classes in Tables 14 and 15. However, they are captured in the 'Other items' line in Table 11, the 'Not allocated to sector cluster' line in Tables 12, 13 and 16, the 'Not allocated to region' line in Table 17 and the 'Not allocated to maturity' line in Table 18. Other tables exclude these items.

IRB and STD approaches

Where applicable, credit risk exposures under the IRB and STD approaches are shown in the same table. However, in the analysis of asset quality (Tables 23 to 32), the two approaches are covered separately. Exposures subject to the supervisory slotting approach are included in IRB amounts.

Definitions used in tables

The following terms appear in column, row or table headings in the tables and are defined in the glossary: IRB approach, asset quality (AQ) bands, counterparty credit risk, credit conversion factor (CCF), credit quality steps (CQS), EAD, exposure class, minimum capital requirements, LGD, PD, RWAs, STD approach, trading book, non-trading book and undrawn commitments.

Other terms specific to the disclosures and tables in this section are defined below:

EAD pre CRM/EAD post CRM - Credit risk mitigation (CRM) is defined as the use of collateral or guarantees to reduce potential loss if a customer fails to settle all or part of its obligations to the Group. The application of CRM depends on the approach (STD or IRB) governing capital calculation related to a credit exposure.

EAD figures may be either pre or post CRM, and are labelled accordingly.

Non-counterparty credit risk EAD pre CRM:

- STD approach - EAD before legally enforceable netting, collateral and guarantees.
- IRB approach - EAD before legally enforceable netting only.

Non-counterparty credit risk EAD post CRM:

- STD approach - EAD after legally enforceable netting, collateral and guarantees.
- IRB approach - EAD after legally enforceable netting only.

Credit risk

Counterparty credit risk EAD post CRM for OTC derivatives and securities financing transactions, under both the STD and IRB approaches, is EAD after legally enforceable netting and collateral.

Defaulted assets (AQ10) - Assets with a PD of 100%.

Exposure-weighted average LGD (for each AQ band) - Calculated by multiplying EAD of each position by associated LGD, giving an LGD-weighted EAD value for each position. LGD-weighted EADs for each position are added together for the whole AQ band, and the final sum is divided by the total EAD for the AQ band to arrive at an exposure-weighted average LGD for each AQ band.

Exposure-weighted average PD (for each AQ band) - Calculated by multiplying EAD of each position by associated PD, giving a PD-weighted EAD for each position. PD-weighted EADs for each position are added together for the whole AQ band, and the final sum is divided by the total PD for the AQ band to arrive at an exposure-weighted average PD for each AQ band.

Geographical region - The numbers are reported by country of operation of the obligor, except exposures to governments and individuals which are shown by country of residence.

The country of operation is the country where the main operating assets of a legal entity are held, or where its main cash flows are generated, taking account of the entity's dependency on subsidiaries' activities. Previously, exposures in this section were reported by country of incorporation. The new basis provides a better reflection of the country risks taken by the Group and is more in line with internal risk management. Prior year information has been revised. Rest of the World (RoW) includes exposures to supranationals and ocean-going vessels.

Not allocated to sector cluster/region/maturity - Comprises non-credit assets, consortium investment exposures and intra-Group exposures.

Residual maturity - the remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement. Exposures are classified using maturity bands in line with contractual maturity.

RWA density - RWAs as a percentage of EAD post CRM.

Undrawn weighted average credit conversion factor (for each AQ band) - Calculated by multiplying the undrawn commitment of each position by the associated CCF, giving a CCF-weighted undrawn for each position. CCF-weighted undrawns for each position are added together for the whole AQ band and the final sum is divided by the total CCFs for the AQ band to arrive at an exposure weighted average CCF for each AQ band.

Western Europe excluding the UK - Andorra, Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Monaco, the Netherlands, Norway, Portugal, San Marino, Spain, Sweden, Switzerland and the Vatican City State (Holy See).

Credit risk

Total credit risk

Table 11: RWA density

Sector cluster	EAD										RWAs				RWA density	
	EAD post CRM			On-balance			Off-balance			RWAs	On-balance		Off-balance		EAD post CRM	EAD drawn balance
	CCR (1)	CCR (1)	Total	Drawn balance	sheet EAD	Undrawn	Undrawn EAD	balance sheet	sheet EAD		sheet RWAs	Undrawn RWAs	sheet RWAs			
														£m		
2013	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	%	%
Sovereign																
Central banks	82,015	12,145	94,160	92,727	94,073	75,537	3	—	84	1,469	1,468	—	1	2	2	
Central government	25,394	947	26,341	25,551	26,238	594	102	3	1	2,448	2,439	9	—	9	9	
Other sovereign	9,560	1,288	10,848	11,788	10,405	1,759	401	47	42	1,600	1,535	59	6	15	15	
Total sovereign	116,969	14,380	131,349	130,066	130,716	77,890	506	50	127	5,517	5,442	68	7	4	4	
Financial institutions (FI)																
Banks	23,744	16,743	40,487	45,878	33,948	20,787	1,147	5,419	5,392	12,611	10,574	357	1,680	31	31	
Other FI (2)	37,679	19,814	57,493	47,640	49,158	19,865	5,056	3,510	3,279	24,331	20,803	2,140	1,388	42	42	
SPVs (3)	20,416	3,671	24,087	22,127	21,661	2,584	2,419	7	7	8,016	7,209	805	2	33	33	
Total FI	81,839	40,228	122,067	115,645	104,767	43,236	8,622	8,936	8,678	44,958	38,586	3,302	3,070	37	37	
Corporates																
Property																
- Western Europe																
- UK	50,675	2,346	53,021	49,644	47,222	10,587	5,057	870	742	27,792	24,752	2,651	389	52	52	
- Ireland	10,295	150	10,445	10,903	10,184	435	228	71	33	5,796	5,652	126	18	55	55	
- Other	7,913	994	8,907	8,705	7,706	3,433	730	1,032	471	5,067	4,384	415	268	57	57	
- US	7,469	184	7,653	5,797	5,839	3,790	1,468	466	346	6,872	5,243	1,318	311	90	90	
- RoW	3,291	605	3,896	3,199	3,320	1,281	268	575	308	3,070	2,617	211	242	79	79	
Total property	79,643	4,279	83,922	78,248	74,271	19,526	7,751	3,014	1,900	48,597	42,648	4,721	1,228	58	57	
Natural resources	28,242	3,987	32,229	21,150	19,599	37,292	8,750	5,014	3,880	18,021	10,960	4,892	2,169	56	56	
Transport	32,017	2,684	34,701	28,773	27,893	14,837	4,680	3,328	2,128	24,387	19,603	3,289	1,495	70	70	
Manufacturing	31,426	998	32,424	24,029	21,256	31,132	8,700	3,785	2,468	21,206	13,902	5,690	1,614	65	65	
Retail and leisure	30,473	1,245	31,718	28,429	25,301	17,161	4,923	1,786	1,494	25,893	20,655	4,018	1,220	82	82	
Services	30,168	1,305	31,473	28,548	26,291	9,722	3,866	1,553	1,316	24,354	20,345	2,991	1,018	77	77	
TMT (4)	14,911	861	15,772	15,811	10,127	15,933	4,609	1,578	1,036	10,668	6,849	3,118	701	68	68	
Total corporates	246,880	15,359	262,239	224,988	204,738	145,603	43,729	20,058	14,222	173,126	134,962	28,719	9,445	66	66	
Personal																
Mortgages																
- Western Europe																
- UK	118,311	—	118,311	108,690	108,700	9,796	9,570	41	41	17,679	16,243	1,430	6	15	15	
- Ireland	17,181	—	17,181	16,841	16,841	62	340	—	—	16,120	15,800	320	—	94	94	
- Other	709	—	709	687	688	20	21	—	—	227	220	7	—	32	32	
- US	19,838	—	19,838	19,753	19,782	9,913	56	—	—	9,771	9,744	27	—	49	49	
- RoW	638	—	638	599	599	46	39	—	—	157	147	10	—	25	25	
Total mortgages	156,677	—	156,677	146,570	146,610	19,837	10,026	41	41	43,954	42,154	1,794	6	28	29	
Other personal	47,826	53	47,879	30,030	29,187	40,829	18,135	634	557	25,989	15,843	9,844	302	54	54	
Total personal	204,503	53	204,556	176,600	175,797	60,666	28,161	675	598	69,943	57,997	11,638	308	34	33	
Other items	23,872	73	23,945		21,945				2,000	19,859	18,200		1,659	83	83	
Total	674,063	70,093	744,156	647,299	637,963	327,395	80,568	29,719	25,625	313,403	255,187	43,727	14,489	42	40	

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

Credit risk

Table 11: RWA density *continued*

Sector cluster	EAD						Off- balance sheet £m	RWAs £m	EAD post CRM RWA density %
	EAD post CRM			Drawn balance £m	Undrawn £m				
	Non-CCR (1) £m	CCR (1) £m	Total £m						
2012									
Sovereign									
Central banks	78,154	13,242	91,396	88,724	65,168	—	2,977		3
Central government	37,694	1,353	39,047	37,752	1,298	10	4,190		11
Other sovereign	7,151	2,675	9,826	9,679	4,656	75	1,657		17
Total sovereign	122,999	17,270	140,269	136,155	71,122	85	8,824		6
Financial institutions (FI)									
Banks	26,887	37,382	64,269	61,624	43,078	5,558	21,669		34
Other FI (2)	42,726	31,488	74,214	58,294	20,359	3,265	25,361		34
SPVs (3)	32,531	7,768	40,299	33,944	6,280	12	12,893		32
Total financial institutions	102,144	76,638	178,782	153,862	69,717	8,835	59,923		34
Corporates									
Property									
- Western Europe									
- UK	57,017	5,460	62,477	57,168	10,953	867	40,366		65
- Ireland	10,943	220	11,163	11,218	393	86	5,624		50
- Other	11,117	1,718	12,835	12,024	3,427	1,234	11,729		91
- US	8,021	391	8,412	6,605	3,527	458	7,633		91
- RoW	5,092	1,100	6,192	5,096	1,254	749	4,438		72
Total property	92,190	8,889	101,079	92,111	19,554	3,394	69,790		69
Natural resources	30,651	4,704	35,355	21,690	38,319	5,609	20,349		58
Transport	36,145	5,023	41,168	34,557	14,384	3,381	26,492		64
Manufacturing	32,458	1,690	34,148	25,941	30,483	4,270	23,733		70
Retail and leisure	33,569	2,042	35,611	30,387	16,669	1,903	27,511		77
Services	30,334	2,033	32,367	26,193	9,967	1,957	25,326		78
TMT (4)	15,716	2,518	18,234	158,576	15,561	1,926	13,622		75
Total corporates	271,063	26,899	297,962	389,455	144,937	22,440	206,823		69
Personal									
Mortgages									
- Western Europe									
- UK	117,709	—	117,709	108,581	9,423	—	18,206		15
- Ireland	17,258	—	17,258	16,939	45	—	16,929		98
- Other	763	—	763	742	20	—	250		33
- US	21,716	—	21,716	21,614	10,587	—	11,289		52
- RoW	761	—	761	724	37	—	221		29
Total mortgages	158,207	—	158,207	148,600	20,112	—	46,895		30
Other personal	50,291	22	50,313	32,141	40,435	146	28,127		56
Total personal	208,498	22	208,520	180,741	60,547	146	75,022		36
Other items	26,670	73	26,743				20,496		77
Total	731,374	120,902	852,276	860,213	346,323	31,506	371,088		44

Notes:

- (1) Counterparty credit risk.
 (2) Non-bank financial institutions.
 (3) Securitisation vehicles.
 (4) Telecoms, media and technology.

Credit risk

Total credit risk *continued*

Table 11: RWA density *continued*

Key points

- Other FIs - An increase, driven by relatively stable RWAs, due in part to changes to credit risk models, but lower EAD, notably in Markets as a result of the expanded internal model method (IMM) waiver for OTC derivatives (as detailed on page 58).
- Corporates: UK property - A decrease, driven by a sharper fall in RWAs than in EAD due to the disposal of capital-intensive assets in Non-Core and the default of certain counterparties: defaulted assets attract a zero risk-weight as they are instead capitalised via a capital deduction.
- Transport - An increase, driven by higher RWAs, as a result of credit risk model changes related to the shipping portfolio, but lower EAD, largely attributable to balance sheet contraction.
- Manufacturing - A decrease, largely driven by a sharper fall in RWAs than in EAD for AIRB exposures in Non-Core, reflecting the disposal of certain equities facilities with high risk-weighted counterparties.

Credit risk

Table 12: Total credit risk EAD, RWAs and minimum capital requirements by sector cluster

		Non-counterparty credit risk				Counterparty credit risk			Total credit risk		
		EAD pre CRM £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m
2013											
Sovereigns and quasi-sovereigns	Central banks	82,015	82,015	1,161	93	12,145	308	25	94,160	1,469	118
	Central governments	25,396	25,394	2,259	181	947	189	15	26,341	2,448	196
	Other sovereign	11,221	9,560	1,242	99	1,288	358	29	10,848	1,600	128
Financial institutions and securitisation vehicles	Banks	25,055	23,744	7,223	578	16,743	5,388	431	40,487	12,611	1,009
	Non-bank financial institutions	39,219	37,679	18,396	1,472	19,814	5,935	475	57,493	24,331	1,947
	Securitisation vehicles	20,415	20,416	6,204	496	3,671	1,812	145	24,087	8,016	641
Corporates	Property	83,447	79,643	45,724	3,658	4,279	2,873	230	83,922	48,597	3,888
	Natural resources	30,553	28,242	16,565	1,325	3,987	1,456	116	32,229	18,021	1,441
	Transport	33,585	32,017	22,997	1,840	2,684	1,390	111	34,701	24,387	1,951
	Manufacturing	34,410	31,426	20,798	1,664	998	408	33	32,424	21,206	1,697
	Retail and leisure	32,938	30,473	25,100	2,008	1,245	793	63	31,718	25,893	2,071
	Services	32,770	30,168	23,500	1,880	1,305	854	68	31,473	24,354	1,948
	Telecoms, media and technology	16,771	14,911	10,191	815	861	477	38	15,772	10,668	853
Personal	Mortgages	156,677	156,677	43,954	3,516	—	—	—	156,677	43,954	3,516
	Other personal	48,782	47,826	25,946	2,076	53	43	3	47,879	25,989	2,079
Not allocated to sector cluster		23,872	23,872	19,803	1,584	73	57	5	23,945	19,860	1,589
		697,126	674,063	291,063	23,285	70,093	22,341	1,787	744,156	313,404	25,072

Credit risk

Total credit risk *continued*

Table 12: Total credit risk EAD, RWAs and minimum capital requirements by sector cluster *continued*

Sector cluster		Non-counterparty credit risk				Counterparty credit risk			Total credit risk		
		EAD pre CRM £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m
2012											
Sovereigns and quasi-sovereigns	Central banks	78,154	78,154	2,867	229	13,242	110	9	91,396	2,977	238
	Central governments	37,694	37,694	3,686	295	1,353	504	40	39,047	4,190	335
	Other sovereign	8,545	7,151	1,262	101	2,675	395	32	9,826	1,657	133
Financial institutions and securitisation vehicles	Banks	27,952	26,887	8,318	665	37,382	13,351	1,068	64,269	21,669	1,733
	Non-bank financial institutions	44,432	42,726	16,153	1,293	31,488	9,208	735	74,214	25,361	2,028
	Securitisation vehicles	32,531	32,531	10,390	831	7,768	2,503	200	40,299	12,893	1,031
Corporates	Property	97,333	92,190	59,762	4,781	8,889	10,028	802	101,079	69,790	5,583
	Natural resources	32,461	30,651	17,192	1,375	4,704	3,157	253	35,355	20,349	1,628
	Transport	37,608	36,145	22,541	1,803	5,023	3,951	316	41,168	26,492	2,119
	Manufacturing	34,998	32,458	23,047	1,844	1,690	686	55	34,148	23,733	1,899
	Retail and leisure	35,901	33,569	26,141	2,091	2,042	1,370	110	35,611	27,511	2,201
	Services	32,174	30,334	24,001	1,920	2,033	1,325	106	32,367	25,326	2,026
	Telecoms, media and technology	17,217	15,716	12,261	981	2,518	1,361	109	18,234	13,622	1,090
Personal	Mortgages	158,207	158,207	46,895	3,752	—	—	—	158,207	46,895	3,752
	Other personal	51,268	50,291	28,108	2,249	22	19	1	50,313	28,127	2,250
Not allocated to sector cluster		26,670	26,670	20,430	1,634	73	66	7	26,743	20,496	1,641
		753,145	731,374	323,054	25,844	120,902	48,034	3,843	852,276	371,088	29,687

Credit risk

Table 13: Total credit risk EAD by sector cluster, geographical region and residual maturity

Sector cluster		EAD post CRM							
		By geographical region				By residual maturity			
		UK £m	US £m	Western Europe (excl. UK) £m	RoW £m	Total £m	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m
2013									
Sovereigns and quasi-sovereigns	Central banks	57,395	18,190	14,501	4,074	94,160	87,247	6,634	279
	Central governments	8,197	7,920	8,223	2,001	26,341	3,063	12,272	11,006
	Other sovereign	2,020	4,905	2,525	1,398	10,848	1,037	2,369	7,442
Financial institutions and securitisation vehicles	Banks	3,804	3,297	17,492	15,894	40,487	21,187	18,043	1,257
	Non-bank financial institutions	20,370	19,644	11,597	5,882	57,493	21,156	25,882	10,455
	Securitisation vehicles	10,941	4,818	6,502	1,826	24,087	5,382	7,671	11,034
Corporates	Property	55,134	7,718	18,876	2,194	83,922	30,284	34,546	19,092
	Natural resources	7,832	10,337	6,185	7,875	32,229	9,405	18,788	4,036
	Transport	13,010	4,823	4,776	12,092	34,701	10,979	17,141	6,581
	Manufacturing	10,812	10,090	6,756	4,766	32,424	12,561	16,218	3,645
	Retail and leisure	19,001	6,605	4,539	1,573	31,718	9,633	15,899	6,186
	Services	19,197	7,435	3,163	1,678	31,473	7,983	13,829	9,661
	Telecoms, media and technology	3,983	5,747	3,808	2,234	15,772	4,780	9,498	1,494
Personal	Mortgages	118,204	19,838	17,887	748	156,677	4,526	14,127	138,024
	Other personal	36,460	8,893	1,451	1,075	47,879	30,885	11,351	5,643
Not allocated to sector cluster						23,945			
		386,360	140,260	128,281	65,310	744,156	260,108	224,268	235,835
2012									
Sovereigns and quasi-sovereigns	Central banks	41,741	14,527	31,177	3,951	91,396	79,865	11,263	268
	Central governments	9,249	14,681	11,483	3,634	39,047	2,931	17,643	18,473
	Other sovereign	2,161	509	4,700	2,456	9,826	2,014	4,560	3,252
Financial institutions and securitisation vehicles	Banks	6,296	10,594	30,851	16,528	64,269	24,969	36,798	2,502
	Non-bank financial institutions	21,221	31,422	14,011	7,560	74,214	24,224	34,338	15,652
	Securitisation vehicles	14,077	9,352	13,432	3,438	40,299	9,654	15,814	14,831
Corporates	Property	65,574	8,439	23,683	3,383	101,079	35,293	46,106	19,680
	Natural resources	7,641	11,455	7,759	8,500	35,355	10,271	20,122	4,962
	Transport	14,387	6,050	5,878	14,853	41,168	8,920	21,426	10,822
	Manufacturing	11,587	9,851	7,772	4,938	34,148	13,361	16,960	3,827
	Retail and leisure	20,689	6,602	6,097	2,223	35,611	11,187	16,790	7,634
	Services	20,439	7,132	3,564	1,232	32,367	8,568	14,141	9,658
	Telecoms, media and technology	5,758	4,959	4,886	2,631	18,234	4,910	12,065	1,259
Personal	Mortgages	117,580	21,716	18,019	892	158,207	3,081	13,996	141,130
	Other personal	37,882	9,110	2,067	1,254	50,313	31,411	12,186	6,716
Not allocated to sector cluster						26,743			
		396,282	166,399	185,379	77,473	852,276	270,659	294,208	260,666

Credit risk

Total credit risk continued

Table 14: Non-counterparty and counterparty credit risk EAD and RWAs by division, regulatory approach and exposure class

The following table shows EAD post CRM and RWAs for the Group's divisions analysed by regulatory approach and exposure class.

	UK Retail		UK Corporate		Wealth		International Banking		Ulster Bank		US R&C		Markets		Central Items		Non-Core		Group	
	EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD	
	post		post		post		post		post		post		post		post		post		post	
	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs
2013	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<i>AIRB approach</i>																				
Central governments and banks	—	—	60	35	—	—	631	49	953	96	—	—	14,029	1,340	29,935	1,963	871	554	46,479	4,037
Institutions	—	—	1,709	87	—	—	10,339	3,827	89	80	—	—	3,389	952	6,446	1,081	758	212	22,730	6,239
Corporates																				
- property	18	17	31,470	22,150	—	—	4,706	3,638	4,851	3,012	—	—	380	330	4,890	365	20,355	5,006	66,670	34,518
- other	54	78	56,872	38,768	—	—	60,499	34,686	6,841	5,261	—	—	10,171	4,795	3,597	3,394	13,189	8,385	151,223	95,367
Retail																				
- mortgages (1)	108,904	19,991	—	—	—	—	—	—	19,411	17,136	—	—	—	—	—	(6,537)	—	—	128,315	30,590
- other	31,014	13,660	10,058	5,450	—	—	—	—	2,525	2,289	—	—	—	—	—	—	215	40	43,812	21,439
Equities	—	—	28	68	—	—	177	560	7	26	—	—	101	319	396	1,205	284	932	993	3,110
Securitisation positions	—	—	1,997	1,450	—	—	5,805	575	9	1	—	—	7,401	918	1,717	191	1,569	222	18,498	3,357
Non-credit obligation assets	1,276	153	217	126	—	—	898	231	95	90	—	—	79	79	2,617	2,625	840	601	6,022	3,905
Total AIRB	141,266	33,899	102,411	68,134	—	—	83,055	43,566	34,781	27,991	—	—	35,550	8,733	49,598	4,287	38,081	15,952	484,742	202,562
<i>STD approach</i>																				
Government and multilateral																				
institutions (2)	—	—	42	7	956	2	17	2	—	—	6,282	24	6,772	—	55,352	11	88	23	69,509	69
Institutions	—	—	—	—	1,484	315	2	1	—	—	281	65	23	9	431	207	114	23	2,335	620
Corporates	108	118	6,441	6,421	2,777	2,765	62	39	40	40	34,370	29,721	237	237	6,503	6,440	2,094	2,048	52,632	47,829
Covered bonds	—	—	—	—	107	11	—	—	—	—	—	—	—	—	—	—	—	—	107	11
Collective investment undertakings	—	—	—	—	—	—	10	10	—	—	—	—	9	9	—	—	5	5	24	24
Retail	146	109	2,928	2,196	1,500	1,122	66	49	96	85	16,050	11,144	—	—	367	285	2,047	1,413	23,200	16,403
Secured by mortgages on																				
- commercial real estate	—	—	62	62	2,498	2,048	1	—	—	—	1,976	1,968	—	—	—	—	237	174	4,774	4,252
- residential property	186	65	148	52	9,161	3,206	367	129	—	—	11,259	3,906	—	—	251	251	169	60	21,541	7,669
Past due items	16	17	41	61	217	227	48	56	18	26	614	767	—	—	1	2	244	347	1,199	1,503
Securitisation positions	—	—	—	—	—	—	—	—	—	—	1,173	401	—	—	—	—	—	—	1,173	401
Other items	412	1,898	309	770	215	305	71	454	375	151	3,877	2,643	2,236	1,810	5,123	732	209	957	12,827	9,720
Total STD	868	2,207	9,971	9,569	18,915	10,001	644	740	529	302	75,882	50,639	9,277	2,065	68,028	7,928	5,207	5,050	189,321	88,501
Total AIRB and STD	142,134	36,106	112,382	77,703	18,915	10,001	83,699	44,306	35,310	28,293	75,882	50,639	44,827	10,798	117,626	12,215	43,288	21,002	674,063	291,063

For the notes to this table refer to page 31.

Credit risk

Table 14: Non-counterparty and counterparty credit risk EAD and RWAs by division, regulatory approach and exposure class *continued*

	UK Retail		UK Corporate		Wealth		International Banking		Ulster Bank		US R&C		Markets		Central Items		Non-Core		Group	
	EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD		EAD	
	post		post		post		post		post		post		post		post		post		post	
	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs	CRM	RWAs
2013	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<i>Counterparty credit risk</i>																				
<i>AIRB approach</i>																				
Central governments and banks	—	—	—	—	—	—	—	—	346	112	—	—	10,048	428	—	—	—	—	10,394	540
Institutions	—	—	—	—	—	—	—	—	30	9	—	—	14,790	5,132	557	89	42	16	15,419	5,246
Corporates	—	—	8	8	—	—	—	—	370	150	—	—	29,166	9,151	316	53	4,751	3,676	34,611	13,038
Equities (3)	—	—	2	5	—	—	—	1	—	—	—	—	—	—	—	—	1	1	3	7
Securitisation positions	—	—	—	—	—	—	—	—	—	—	—	—	2,110	793	—	—	12	31	2,122	824
Total AIRB	—	—	10	13	—	—	—	1	746	271	—	—	56,114	15,504	873	142	4,806	3,724	62,549	19,655
<i>STD approach</i>																				
Governments and multilateral institutions (2)	—	—	—	—	—	—	—	—	—	—	—	—	4,658	23	7	—	—	—	4,665	23
Institutions	—	—	—	—	31	6	—	—	—	—	5	1	444	355	13	7	—	—	493	369
Corporates	—	—	—	—	8	8	—	—	—	—	492	489	1,645	1,578	184	170	3	3	2,332	2,248
Retail	—	—	—	—	42	31	—	—	—	—	—	—	—	—	—	—	—	—	42	31
Past due items	—	—	—	—	—	—	—	—	3	5	4	4	—	—	—	—	2	3	9	12
Other items	—	—	—	—	3	3	—	—	—	—	—	—	—	—	—	—	—	—	3	3
Total STD	—	—	—	—	84	48	—	—	3	5	501	494	6,747	1,956	204	177	5	6	7,544	2,686
Total AIRB and STD	—	—	10	13	84	48	—	1	749	276	501	494	62,861	17,460	1,077	319	4,811	3,730	70,093	22,341

Notes:

- (1) UK Retail RWAs include £6.5 billion adjustment to reflect long-term conservative average secured mortgage probability of default methodology rather than the lower point in time basis required for regulatory reporting. Central items include an off-set adjustment, therefore Group RWAs reflect regulatory approach.
- (2) Governments and multilateral institutions comprises: central governments or central banks, regional governments or local authorities, administrative bodies and non-commercial undertakings, and multilateral development banks.
- (3) The equities exposures represent equity warrants held by the Group, granting it the option to purchase shares in corporate entities. For accounting purposes, the warrants are treated as OTC derivatives and thus reported under counterparty credit risk in regulatory disclosures.

Credit risk

Total credit risk *continued*

Table 15: Non-counterparty and counterparty credit risk EAD, RWAs and minimum capital requirements by regulatory approach and exposure class

Exposure class	Non-counterparty credit risk					Counterparty credit risk		
	EAD pre CRM £m	Average EAD pre CRM £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m
2013								
<i>IRB approach</i>								
Central governments and banks	46,480	66,777	46,479	4,037	323	10,394	540	43
Institutions	25,665	26,059	22,730	6,239	499	15,419	5,246	420
Corporates	236,229	252,251	217,893	129,885	10,391	34,611	13,038	1,043
Retail								
SMEs	11,356	12,082	11,357	6,750	540	—	—	—
secured by real estate collateral	128,318	128,201	128,315	30,590	2,447	—	—	—
qualifying revolving retail	26,224	26,203	26,226	9,015	721	—	—	—
other retail	6,229	6,650	6,229	5,674	454	—	—	—
	172,127	173,136	172,127	52,029	4,162	—	—	—
Equities								
exchange-traded	582	587	582	1,795	143	—	—	—
private equity	102	196	102	269	22	3	6	—
other	309	276	309	1,046	84	—	1	—
	993	1,059	993	3,110	249	3	7	—
Securitisation positions	18,498	23,454	18,498	3,357	269	2,122	824	66
Non-credit obligation assets	6,022	8,824	6,022	3,905	312	—	—	—
	506,014	551,560	484,742	202,562	16,205	62,549	19,655	1,572
<i>STD approach</i>								
Central governments and banks	68,896	59,341	68,896	1	—	4,531	—	—
Regional governments or local authorities	577	972	542	58	5	134	23	2
Administrative bodies and non-commercial undertakings	50	61	50	10	1	—	—	—
Multilateral development banks	21	16	21	—	—	—	—	—
Institutions	2,335	3,630	2,335	620	50	493	369	29
Covered bonds	107	43	107	11	1	—	—	—
Collective investment undertakings	24	19	24	24	2	—	—	—
Corporates	54,116	60,767	52,632	47,829	3,826	2,332	2,248	181
Retail	23,469	31,164	23,200	16,403	1,313	42	31	2
Secured by mortgages on								
- commercial real estate	4,776	6,518	4,774	4,252	340	—	—	—
- residential property	21,541	21,144	21,541	7,669	613	—	—	—
Past due items	1,200	1,436	1,199	1,503	120	9	12	1
Securitisation positions	1,173	725	1,173	401	32	—	—	—
Other items	12,827	12,852	12,827	9,720	777	3	3	—
	191,112	198,688	189,321	88,501	7,080	7,544	2,686	215
Total	697,126	750,248	674,063	291,063	23,285	70,093	22,341	1,787

Credit risk

Table 15: Non-counterparty and counterparty credit risk EAD, RWAs and minimum capital requirements by regulatory approach and exposure class *continued*

Exposure class	Non-counterparty credit risk					Counterparty credit risk		
	EAD pre CRM £m	Average EAD pre CRM £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m	EAD post CRM £m	RWAs £m	Minimum capital requirement £m
2012								
<i>IRB approach</i>								
Central governments and banks	70,087	91,572	70,087	6,731	539	11,231	742	59
Institutions	26,018	31,382	23,652	6,919	553	36,618	13,275	1,062
Corporates	257,517	284,556	239,801	143,630	11,492	57,842	28,587	2,286
Retail								
SMEs	12,865	13,495	12,865	7,993	639	—	—	—
secured by real estate collateral	127,708	126,832	127,708	31,987	2,559	—	—	—
qualifying revolving retail	26,780	26,761	26,780	9,540	763	—	—	—
other retail	7,060	7,525	7,060	6,320	506	—	—	—
	174,413	174,613	174,413	55,840	4,467	—	—	—
Equities								
exchange-traded	665	490	665	1,846	147	—	—	—
private equity	340	381	340	777	63	—	—	—
other	309	514	309	902	72	—	—	—
	1,314	1,385	1,314	3,525	282	—	—	—
Securitisation positions	28,627	34,217	28,627	5,999	480	3,869	1,358	109
Non-credit obligation assets	10,447	13,526	10,447	7,972	638	—	—	—
	568,423	631,251	548,341	230,616	18,451	109,560	43,962	3,516
<i>STD approach</i>								
Central governments and banks	53,113	48,666	53,113	3	—	5,678	9	1
Regional governments or local authorities	1,665	2,038	1,614	85	7	175	28	2
Administrative bodies and non-commercial undertakings	65	126	65	16	1	—	—	—
Multilateral development banks	12	23	12	—	—	2	—	—
Institutions	4,428	4,350	4,428	1,052	84	787	224	17
Corporates	54,887	55,487	53,606	47,610	3,809	4,678	3,791	305
Retail	27,388	29,140	27,047	18,971	1,517	12	9	1
Secured by mortgages on								
- commercial real estate	7,441	8,633	7,435	6,967	557	8	8	1
- residential property	20,759	20,498	20,758	7,314	585	—	—	—
Past due items	1,652	1,448	1,643	2,173	174	2	3	—
Securitisation positions	263	661	263	262	21	—	—	—
Other items	13,049	14,447	13,049	7,985	638	—	—	—
	184,722	185,517	183,033	92,438	7,393	11,342	4,072	327
Total	753,145	816,768	731,374	323,054	25,844	120,902	48,034	3,843

Credit risk

Non-counterparty credit risk

Table 16: Non-counterparty credit risk by exposure class and sector cluster

The following table maps exposures classified by sector cluster (in line with the Group's internal risk management process) to exposures classified by exposure class (as defined by BIPRU rules for calculating regulatory capital).

	EAD pre CRM															
	Sovereigns and quasi-sovereigns			Financial institutions and securitisation vehicles			Corporates							Personal		Total
	Central banks £m	Central governments £m	Other sovereign £m	Banks £m	Non-bank financial institutions £m	Securitisation vehicles £m	Property £m	Natural resources £m	Transport £m	Manufacturing £m	Retail and leisure £m	Services £m	Telecoms, media and technology £m	Mortgages £m	Other personal £m	
2013																
<i>IRB approach</i>																
Central governments and banks	27,223	16,983	1,174	1,003	—	—	—	—	—	—	—	97	—	—	—	46,480
Institutions	—	—	4,346	21,185	3	3	—	—	50	—	75	3	—	—	—	25,665
Corporates	—	—	178	446	24,454	1,417	70,468	27,627	29,195	24,849	22,446	20,223	14,020	11	895	236,229
Retail	—	—	18	—	123	—	2,927	48	609	1,792	2,499	2,881	280	128,327	32,623	172,127
Equities	—	—	—	—	412	—	145	—	10	13	8	129	78	—	—	795
Securitisation positions	—	—	—	—	1,496	16,759	—	—	92	—	—	151	—	—	—	18,498
Non-credit obligation assets	—	19	78	101	71	—	173	53	639	34	200	39	58	—	—	1,465
	27,223	17,002	5,794	22,735	26,559	18,179	73,713	27,728	30,595	26,688	25,228	23,523	14,436	128,338	33,518	501,259
<i>STD approach</i>																
Central governments and banks	54,513	8,354	4,768	—	—	—	—	—	—	—	—	21	—	—	—	67,656
Regional governments or local authorities	—	—	514	—	11	—	—	—	—	—	11	—	—	—	—	536
Administrative bodies and non-commercial undertakings	—	—	—	—	50	—	—	—	—	—	—	—	—	—	—	50
Multilateral development banks	—	—	—	19	—	—	—	—	—	—	—	—	—	—	—	19
Institutions	—	—	—	1,828	76	—	—	—	—	—	—	—	—	—	—	1,904
Corporates	—	27	65	6	10,486	1,635	5,965	2,346	2,303	6,965	6,329	7,228	2,167	402	2,213	48,137
Covered bonds	—	—	—	27	80	—	—	—	—	—	—	—	—	—	—	107
Collective investment undertakings	—	—	—	—	8	—	—	16	—	—	—	—	—	—	—	24
Retail	—	—	17	3	162	169	487	100	231	364	865	942	76	8,597	11,089	23,102
Secured by mortgages on																
- commercial real estate	—	—	8	—	388	18	2,192	6	61	124	379	655	33	341	571	4,776
- residential property	—	—	1	—	451	—	648	—	1	9	22	314	8	18,551	1,285	21,290
Past due items	—	—	—	—	113	—	261	11	93	35	70	40	23	448	106	1,200
Securitisation positions	—	—	—	146	613	414	—	—	—	—	—	—	—	—	—	1,173
Other items	279	13	54	291	222	—	181	346	301	225	34	47	28	—	—	2,021
	54,792	8,394	5,427	2,320	12,660	2,236	9,734	2,825	2,990	7,722	7,710	9,247	2,335	28,339	15,264	171,995
	82,015	25,396	11,221	25,055	39,219	20,415	83,447	30,553	33,585	34,410	32,938	32,770	16,771	156,677	48,782	673,254
Not allocated to sector cluster																23,872
																697,126

Credit risk

Table 16: Non-counterparty credit risk by exposure class and sector cluster *continued*

Exposure class	EAD pre CRM															
	Sovereigns and quasi-sovereigns			Financial institutions and securitisation vehicles			Corporates							Personal		Total
	Central banks £m	Central governments £m	Other sovereign £m	Banks £m	Non-bank financial institutions £m	Securitisation vehicles £m	Property £m	Natural resources £m	Transport £m	Manufacturing £m	Retail and leisure £m	Services £m	Telecoms, media and technology £m	Mortgages £m	Other personal £m	
2012																
<i>IRB approach</i>																
Central governments and banks	39,141	28,174	1,569	1,034	—	—	—	—	—	—	—	169	—	—	—	70,087
Institutions	—	—	4,077	21,914	9	—	—	—	17	—	—	1	—	—	—	26,018
Corporates	—	—	938	430	26,100	2,055	82,381	29,007	32,226	24,567	24,121	20,076	14,268	17	1,331	257,517
Retail	—	—	19	—	141	—	3,199	53	696	2,120	2,846	3,174	314	127,721	34,130	174,413
Equities	—	—	—	1	540	—	209	—	7	187	88	23	57	—	—	1,112
Securitisation positions	—	—	—	—	796	26,769	234	108	93	—	627	—	—	—	—	28,627
Non-credit obligation assets	—	18	91	101	88	—	192	70	1,310	35	218	67	69	—	—	2,259
	39,141	28,192	6,694	23,480	27,674	28,824	86,215	29,238	34,349	26,909	27,900	23,510	14,708	127,738	35,461	560,033
<i>STD approach</i>																
Central governments and banks	38,710	9,484	11	—	3,728	—	—	—	—	—	—	21	—	—	—	51,954
Regional governments or local authorities	—	—	1,615	—	—	—	4	—	—	—	—	1	—	—	—	1,620
Administrative bodies and non-commercial undertakings	—	—	13	—	9	—	—	—	—	—	—	43	—	—	—	65
Multilateral development banks	—	—	—	3	—	—	—	—	—	—	—	—	—	—	—	3
Institutions	—	—	—	3,972	85	—	—	—	—	—	—	—	—	—	11	4,068
Corporates	—	18	147	140	11,689	3,080	4,691	2,762	2,572	7,398	6,151	6,368	2,379	358	2,009	49,762
Retail	—	—	23	4	206	269	531	83	238	375	999	979	82	11,317	11,893	26,999
Secured by mortgages on																
- commercial real estate	—	—	13	—	370	46	4,845	49	53	69	580	751	24	283	358	7,441
- residential property	—	—	1	—	505	73	316	—	2	14	55	313	4	18,067	1,323	20,673
Past due items	—	—	1	—	46	—	668	3	32	26	182	51	6	443	194	1,652
Securitisation positions	—	—	—	—	24	239	—	—	—	—	—	—	—	—	—	263
Other items	303	—	27	353	96	—	63	326	362	207	34	137	14	1	19	1,942
	39,013	9,502	1,851	4,472	16,758	3,707	11,118	3,223	3,259	8,089	8,001	8,664	2,509	30,469	15,807	166,442
	78,154	37,694	8,545	27,952	44,432	32,531	97,333	32,461	37,608	34,998	35,901	32,174	17,217	158,207	51,268	726,475
Not allocated to sector cluster																26,670
																753,145

Credit risk

Non-counterparty credit risk *continued*

Non-counterparty credit risk RWAs and minimum capital requirements related to equities are comprised as follows:

	RWAs	Minimum capital requirements	
	2013	2013	2012
	£m	£m	£m
IRB (PD/LGD) approach	853	68	124
Simple risk-weighted approach	1,633	131	130
Consortium investment exposures	624	50	28
	3,110	249	282

For analysis of the inputs to these capital calculations, refer to Table 29 (PD/LGD approach) and Table 30 (simple risk-weighted approach).

Table 17: Non-counterparty credit risk by exposure class and geographical region

Exposure class	EAD pre CRM				
	UK	US	Western Europe (excl. UK)	RoW	Total
	£m	£m	£m	£m	£m
2013					
<i>IRB approach</i>					
Central governments and banks	885	24,323	13,701	7,571	46,480
Institutions	4,151	1,521	10,157	9,836	25,665
Corporates	121,231	24,068	57,513	33,417	236,229
Retail	152,342	176	19,009	600	172,127
Equities	350	52	263	130	795
Securitisation positions	7,010	4,693	4,942	1,853	18,498
Non-credit obligation assets	630	—	835	—	1,465
	286,599	54,833	106,420	53,407	501,259
<i>STD approach</i>					
Central governments and banks	60,571	6,168	891	26	67,656
Regional governments or local authorities	34	69	377	56	536
Administrative bodies and non-commercial undertakings	—	50	—	—	50
Multilateral development banks	—	—	—	19	19
Institutions	131	289	1,059	425	1,904
Corporates	9,392	34,661	1,305	2,779	48,137
Covered bonds	—	—	107	—	107
Collective investment undertakings	—	24	—	—	24
Retail	4,441	17,859	429	373	23,102
Secured by mortgages on					
- commercial real estate	2,238	2,070	193	275	4,776
- residential property	8,324	11,465	513	988	21,290
Past due items	316	692	149	43	1,200
Securitisation positions	—	1,114	59	—	1,173
Other items	237	1,764	4	16	2,021
	85,684	76,225	5,086	5,000	171,995
	372,283	131,058	111,506	58,407	673,254
Not allocated to region					23,872
					697,126

Credit risk

Table 17: Non-counterparty credit risk by exposure class and geographical region *continued*

Exposure class	EAD pre CRM				
	UK £m	US £m	Western Europe (excl. UK) £m	RoW £m	Total £m
2012					
<i>IRB approach</i>					
Central governments and banks	821	27,115	33,775	8,376	70,087
Institutions	4,339	1,945	10,507	9,227	26,018
Corporates	129,739	24,812	65,933	37,033	257,517
Retail	153,663	158	20,035	557	174,413
Equities	466	49	464	133	1,112
Securitisation positions	8,194	7,968	9,526	2,939	28,627
Non-credit obligation assets	1,018	—	1,226	15	2,259
	298,240	62,047	141,466	58,280	560,033
<i>STD approach</i>					
Central governments and banks	45,416	5,297	874	367	51,954
Regional governments or local authorities	23	113	1,384	100	1,620
Administrative bodies and non-commercial undertakings	—	61	—	4	65
Multilateral development banks	—	—	—	3	3
Institutions	44	183	3,196	645	4,068
Corporates	8,823	33,795	3,512	3,632	49,762
Retail	4,968	20,659	687	685	26,999
Secured by mortgages on					
- commercial real estate	2,027	4,702	346	366	7,441
- residential property	8,431	10,280	732	1,230	20,673
Past due items	296	599	646	111	1,652
Securitisation positions	—	263	—	—	263
Other items	204	1,738	—	—	1,942
	70,232	77,690	11,377	7,143	166,442
	368,472	139,737	152,843	65,423	726,475
Not allocated to region					26,670
					753,145

Credit risk

Non-counterparty credit risk *continued*

Table 18: Non-counterparty credit risk by exposure class and residual maturity

Exposure class	EAD pre CRM			Total £m
	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	
2013				
<i>IRB approach</i>				
Central governments and banks	30,420	10,751	5,309	46,480
Institutions	15,203	6,902	3,560	25,665
Corporates	98,484	93,409	44,336	236,229
Retail	34,707	11,301	126,119	172,127
Equities	—	—	795	795
Securitisation positions	5,476	3,476	9,546	18,498
Non-credit obligation assets	427	332	706	1,465
	184,717	126,171	190,371	501,259
<i>STD approach</i>				
Central governments and banks	48,783	8,292	10,581	67,656
Regional governments or local authorities	83	223	230	536
Administrative bodies and non-commercial undertakings	27	23	—	50
Multilateral development banks	—	19	—	19
Institutions	1,814	90	—	1,904
Corporates	5,601	31,872	10,664	48,137
Covered bonds	—	107	—	107
Collective investment undertakings	—	—	24	24
Retail	4,058	10,257	8,787	23,102
Secured by mortgages on				
- commercial real estate	852	3,149	775	4,776
- residential property	2,365	6,097	12,828	21,290
Past due items	455	380	365	1,200
Securitisation positions	—	26	1,147	1,173
Other items	80	406	1,535	2,021
	64,118	60,941	46,936	171,995
	248,835	187,112	237,307	673,254
Not allocated to maturity				23,873
				697,127

Credit risk

Table 18: Non-counterparty credit risk by exposure class and residual maturity *continued*

	EAD pre CRM			
Exposure class	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
2012				
IRB approach				
Central governments and banks	42,182	16,296	11,609	70,087
Institutions	14,607	6,518	4,893	26,018
Corporates	99,106	106,291	52,120	257,517
Retail	36,018	11,402	126,993	174,413
Equities	—	176	936	1,112
Securitisation positions	8,915	5,524	14,188	28,627
Non-credit obligation assets	774	564	921	2,259
	201,602	146,771	211,660	560,033
STD approach				
Central governments and banks	29,218	12,273	10,463	51,954
Regional governments or local authorities	117	961	542	1,620
Administrative bodies and non-commercial undertakings	12	46	7	65
Multilateral development banks	—	3	—	3
Institutions	3,908	159	1	4,068
Corporates	6,318	32,959	10,485	49,762
Retail	4,025	11,160	11,814	26,999
Secured by mortgages on				
- commercial real estate	1,389	4,516	1,536	7,441
- residential property	896	5,904	13,873	20,673
Past due items	377	842	433	1,652
Securitisation positions	—	—	263	263
Other items	94	443	1,405	1,942
	46,354	69,266	50,822	166,442
	247,956	216,037	262,482	726,475
Not allocated to maturity				26,670
				753,145

Key points for Tables 12 to 18

Overview

The Group's total credit risk exposures decreased during 2013, with EAD post CRM falling 13% to £744.2 billion at 31 December 2013 from £852.3 billion at 31 December 2012.

For non-counterparty credit risk, the key drivers of the 8% decline in EAD post CRM were the Group's continuing exit from legacy capital intensive business lines through disposals in Non-Core. The decrease was primarily evident in the following sector clusters: property, mainly commercial real estate; and securitisation vehicles, as a result of run-offs in the structured credit portfolio.

For counterparty credit risk, the key driver of the 42% decline was the Group's successful deployment of an expanded internal model waiver for regulatory capital calculations applying to OTC derivatives.

The Group's exposures subject to the IRB approach fell, driving the overall reduction in exposure. This decline was partially offset by a rise in exposures subject to the STD approach, primarily reflecting increased placements of excess liquidity with the Bank of England.

RWAs declined more sharply than EAD: total credit risk RWAs fell 16% to £313.4 billion at 31 December 2013 from £371.1 billion at 31 December 2012. The sharper decline in RWAs than in EAD was primarily due to a large fall in RWAs in the central government sector cluster, driven by the increase in Bank of England exposures, which are zero risk-weighted under the STD approach, offsetting a decrease in Deutsche Bundesbank exposures, which carry a risk-weight under the IRB approach.

The major year-on-year changes in both sector cluster and exposure class amounts shown in the preceding tables were driven by the following key developments:

Commercial real estate

Overall exposure to commercial real estate fell significantly in 2013, driven primarily by a reduced concentration in the UK and, less significantly, Western Europe. Non-Core accounted for most of the decrease given its asset disposal strategy, coupled with the maturing of facilities, loan prepayments and amortisations. This reduction is evident in the property sector cluster and in the corporates exposure class.

Credit risk

Non-counterparty credit risk *continued*

Key points for Tables 12 to 18 *continued*

Reduction in securitisation related exposures

The Group continued to reduce securitisation positions through run-offs both in the structured credit portfolio in Non-Core and in the conduit business. This was reflected by the decrease in exposures under the IRB approach, particularly in Western Europe and the Rest of the World. A number of existing securitised exposures are now reported as capital deductions instead of RWAs and so the underlying portfolios are no longer reported against the corporate exposure class under the STD approach. For additional information, refer to pages 66 to 77.

Liquidity management

Fluctuations in the Group's balances with central banks and central governments reflect Group Treasury's asset and liability management.

During 2013, the Group experienced a significant increase in excess sterling cash balances, in part due to the sale of UK government bonds. It therefore increased its placements of cash with the Bank of England, contributing significantly to the rise in exposures under the STD approach.

For exposures under the IRB approach, an increase in cash placements with the Federal Reserve Bank of New York was offset by a reduction in placements with the Deutsche Bundesbank. The latter reflected reduced excess euro cash balances and was the key driver of the overall fall in the Group's Western European credit risk exposures.

For more information, refer to the country risk section on pages 341 to 353 of the Group's 2013 Annual Report and Accounts.

Challenging economic conditions

Challenging economic conditions contributed to a fall in business volumes in most sector clusters, and in all regions in which the Group operates. Limited new business opportunities failed to offset amortisations, the maturing of facilities and prepayments.

Sterling appreciation

The foreign exchange impact for 2013 was relatively flat for the wholesale portfolio as the US dollar depreciated by 2.3% against sterling, whereas the euro appreciated by 2.2%. The majority of the retail portfolio is sterling denominated.

Moderate declines in personal sector

The moderate decline in the mortgage sector cluster was driven by a contraction in the home equity loan portfolio and home equity lines of credit in the US, as amortisation outpaced new business. This was partly offset by a small increase in the UK, where reaccreditation and training was provided to mortgage advisors early in the year in preparation for regulatory changes due in the second quarter of 2014.

The decline in the other personal sector cluster mainly reflected a reduction in the granting of unsecured loans of up to £25,000 to personal customers in the UK. This portfolio has been decreasing in value and volume for several years as repayments and closures have consistently more than offset levels of new business, due to tightening lending criteria and less competitive pricing.

Expanded internal model method waiver

In the fourth quarter of 2013, the PRA granted the Group an expanded IMM waiver for regulatory capital calculations for counterparty credit risk associated with OTC derivatives. The new models and greater product coverage under the new IMM waiver and the associated reduction in the multiplier (or alpha factor) applied to the capital calculations have, in combination, had a significant downward impact on the EAD and RWAs associated with the Group's OTC derivative transactions. This impact was a significant contributor to the reduction in US and Western European exposures. For more details on the IMM waiver and the alpha factor, refer to page 58.

Also contributing, though less significantly, to the overall reduction in counterparty credit risk EAD was the upward shift in interest rate swap curves across all major currencies, which resulted in an overall reduction in the gap between interest received and paid by the Group in its interest rate swaps. This impact contributed to the reductions in UK, US and, less significantly, Western European exposures. For more information, refer to page 59.

Credit risk mitigation

The Group employs a number of techniques to mitigate credit risk. For information on the Group's approach to CRM, including collateral and other credit enhancements, refer to pages 237 to 241 of the Group's 2013 Annual Report and Accounts. For specific information on the mitigation of counterparty credit risk, refer to pages 58 to 62 of this report.

Under the STD approach, CRM is incorporated in EAD or risk-weight as per BIPRU rules.

The following table details how different risk mitigants are incorporated into IRB risk parameters (LGD, PD and EAD).

Credit risk

Table 19: Incorporation of credit risk mitigants within IRB risk parameters

	LGD	PD	EAD
Real estate (commercial and residential)	✓		
Other physical collateral	✓		
Third party guarantees	✓		
Credit derivatives	✓		
Parental guarantees (connected parties)		✓	
Financial collateral			
- trading book			✓
- non-trading book	✓		
Netting (on and off-balance sheet)			✓
Receivables	✓		
Life policies	✓		
Credit insurance	✓		

Table 20: Non-counterparty credit risk exposures covered by guarantees and credit derivatives

The following table details total exposures covered by guarantees and credit derivatives. For further detail on collateral, refer to pages 237 to 241 of the Group's 2013 Annual Report and Accounts.

Exposure class	2013	2012
	Exposures covered by guarantees or credit derivatives (1,2) £m	Exposures covered by guarantees or credit derivatives (1,2) £m
<i>IRB approach</i>		
Central governments and banks	77	13
Institutions	168	749
Corporates	7,815	8,527
Non-credit obligation assets	—	3
	8,060	9,292
<i>STD approach</i>		
Central governments and banks	4,757	3,436
Corporates	18	16
Retail	413	488
Secured by mortgages on residential property	434	316
Past due items	24	17
	5,646	4,273
	13,706	13,565

Notes:

- (1) Exposures covered by guarantees or credit derivatives are shown as the lower of the value of the guarantee or credit derivative or the value of the associated EAD post CRM of the facility. Guarantees disclosed do not include parental guarantees where the PD substitution approach is applied.
- (2) Excludes tranching credit protection purchased in relation to synthetic securitisation activity.

Key point

- Exposures covered by guarantees or credit derivatives remained broadly flat, in contrast to the overall 7% reduction in non-counterparty credit risk EAD pre CRM. This reflects the Group's continued focus on credit risk mitigation opportunities.

Credit risk

Credit risk mitigation *continued*

Table 21: Non-counterparty credit risk exposures covered by eligible financial collateral (STD approach)

STD exposure class ⁽¹⁾	2013 £m	2012 £m
Corporates	1,478	1,243
Retail	269	341
Secured by mortgages on commercial real estate	2	5
Secured by mortgages on residential property	1	—
Past due items	1	—
	1,751	1,589

Note:

(1) Exposures covered by eligible financial collateral as per BIPRU rules.

Key point

- Exposures covered by eligible financial collateral subject to the STD approach increased by 10%, a sharper rise than that in the Group's overall STD non-counterparty credit risk exposures (3%). This distinction reflects the Group's continued focus on credit risk mitigation opportunities.

Asset quality analysis of non-counterparty credit risk exposures

Under the IRB approach, the Group utilises a master grading scale comprising 27 grades to express the default risk of its exposures. These grades are mapped to ten AQ bands for both internal and external reporting purposes. The relationship between the AQ bands and PDs is detailed in the following table.

Tables 23 to 29 analyse the asset quality of the Group's non-counterparty credit risk exposures using the IRB approach. For these exposures, the asset quality is disclosed according to the Group's internal AQ bands, as defined in Table 22. Table 32 shows the asset quality of the Group's non-counterparty credit risk exposures under the STD approach. For these exposures, asset quality is disclosed according to CQS, as defined in Table 31.

The following table additionally details, for illustrative purposes only, the relationship between the Group's master grading scale and AQ bands, on the one hand, and external ratings published by S&P, on the other hand. This relationship is established by observing S&P's default study statistics, notably the one year default rates for each S&P rating grade. A degree of judgement is required to relate the PD ranges associated with the master grading scale to these default rates given that, for example, the S&P published default rates do not increase uniformly by grade and the historical default rate is nil for the highest rating categories.

The mapping to the S&P ratings is used by the Group as one of several benchmarks for its wholesale portfolios, depending on customer type and the purpose of the benchmark. The mapping shown below and in the following tables is based on all issuer types rated by S&P. It should therefore be considered illustrative and does not, for instance, indicate that exposures reported against S&P ratings either have been or would be assigned those ratings if assessed by S&P. In addition, the relationship is not relevant for retail portfolios, smaller corporate exposures or specialist corporate segments given that S&P does not typically assign ratings to such issuers.

Credit risk

Table 22: AQ band mapping to PD range

Master grading scale	AQ band	PD range		S&P ratings
		Low	High	
1	AQ1	0%	0.006%	AAA
2		0.006%	0.012%	AA+
3		0.012%	0.017%	AA+
4		0.017%	0.024%	AA
5		0.024%	0.034%	AA
6	AQ2	0.034%	0.048%	AA-
7	AQ3	0.048%	0.067%	A+
8		0.067%	0.095%	A
9	AQ4	0.095%	0.135%	A-
10		0.135%	0.190%	BBB+
11		0.190%	0.269%	BBB
12		0.269%	0.381%	BBB-
13	AQ5	0.381%	0.538%	BB+
14		0.538%	0.761%	BB+
15		0.761%	1.076%	BB
16	AQ6	1.076%	1.522%	BB-
17		1.522%	2.153%	BB-
18	AQ7	2.153%	3.044%	B+
19		3.044%	4.305%	B
20		4.305%	6.089%	B
21	AQ8	6.089%	8.611%	B-
22		8.611%	12.177%	B-
23		12.177%	17.222%	CCC+
24	AQ9	17.222%	24.355%	CCC+
25		24.355%	34.443%	CCC
26		34.443%	100%	CCC- to C
27	AQ10	100%	100%	D

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Tables 23 to 29 analyse the asset quality of the Group's non-counterparty credit risk exposures using the IRB approach. For these exposures, the asset quality is disclosed according to the Group's internal AQ bands, as defined in Table 22. These tables exclude products where no PDs exist, such as securitisation positions and non-credit obligation assets.

Table 23: Total IRB non-counterparty credit risk exposures post CRM by AQ band

IRB exposure class	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	AQ6 £m	AQ7 £m	AQ8 £m	AQ9 £m	AQ10/default £m	Total £m
2013											
Central governments and banks	41,043	371	2,967	2,023	11	15	44	4	1	—	46,479
Institutions	2,992	1,568	6,992	9,999	791	105	103	110	1	69	22,730
Corporates (1)	37,434	14,867	19,683	25,783	25,289	20,655	13,544	3,545	1,955	20,126	182,881
Retail											
SMEs	—	16	—	1,070	1,713	3,858	1,449	1,125	327	1,799	11,357
secured by real estate collateral	—	2,681	—	58,746	35,994	10,546	8,868	2,275	3,302	5,903	128,315
qualifying revolving retail exposures	154	7,613	—	4,302	4,569	3,319	3,252	1,779	320	918	26,226
other retail exposures	—	—	—	10	1,327	1,579	1,154	452	140	1,567	6,229
	154	10,310	—	64,128	43,603	19,302	14,723	5,631	4,089	10,187	172,127
Equities (2)	—	—	—	—	10	120	105	1	26	22	284
Total	81,623	27,116	29,642	101,933	69,704	40,197	28,519	9,291	6,072	30,404	424,501
2012											
Central governments and banks	62,481	697	4,340	2,103	382	15	56	6	7	—	70,087
Institutions	6,807	2,208	4,003	8,920	1,352	128	105	4	1	124	23,652
Corporates (1)	38,062	14,253	21,098	30,580	35,163	24,603	16,724	5,429	3,612	28,939	218,463
Retail											
SMEs	—	—	16	1,139	958	4,755	2,264	1,306	501	1,927	12,866
secured by real estate collateral	4	3,739	—	52,819	40,013	8,914	9,617	2,775	3,910	5,917	127,708
qualifying revolving retail exposures	138	7,253	126	4,299	4,944	3,185	2,846	2,592	367	1,028	26,778
other retail exposures	—	—	—	93	1,279	1,789	1,017	832	192	1,859	7,061
	142	10,992	142	58,350	47,194	18,643	15,744	7,505	4,970	10,731	174,413
Equities (2)	—	—	36	—	196	168	232	1	1	17	651
Total	107,492	28,150	29,619	99,953	84,287	43,557	32,861	12,945	8,591	39,811	487,266

Notes:

(1) Excludes exposures treated under the supervisory slotting approach. For more information, refer to Table 27.

(2) Excludes exposures calculated using the simple risk-weight approach. For more information, refer to Tables 16 and 30.

Credit risk

Tables 24 to 29 analyse each of the exposure classes in turn, detailing the key parameters of the IRB RWA calculation for each of them.

Table 24: Central governments and central banks IRB non-counterparty credit risk exposures post CRM by AQ band

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
S&P ratings	AAA to AA	AA-	A+ to A	A- to BBB-	BB+ to BB	BB-	B+ to B	B- to CCC+	CCC to C	D	
EAD post CRM (£m)	41,043	371	2,967	2,023	11	15	44	4	1	—	46,479
Exposure-weighted average LGD	44.9%	45.0%	45.0%	48.2%	62.8%	24.5%	36.6%	18.6%	79.2%	—	45.1%
Exposure-weighted average PD	0.01%	0.04%	0.06%	0.24%	0.54%	1.66%	3.74%	10.60%	28.96%	—	0.03%
RWAs (£m)	2,300	114	446	1,102	9	9	49	4	4	—	4,037
RWA density	5.6%	30.7%	15.0%	54.4%	89.1%	56.8%	111.9%	91.9%	439.7%	—	8.7%
Undrawn commitments (£m)	31,889	10	3,083	1,470	42	18	2	—	9	—	36,523
Undrawn weighted average CCF	0.2%	23.1%	0.2%	5.4%	23.8%	23.7%	100.0%	—	—	—	0.5%

2012	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	62,481	697	4,340	2,103	382	15	56	6	7	—	70,087
Exposure-weighted average LGD	44.4%	45.1%	38.4%	46.0%	40.4%	11.3%	19.8%	13.3%	87.5%	—	44.0%
Exposure-weighted average PD	0.01%	0.04%	0.06%	0.24%	0.56%	1.81%	3.48%	10.55%	28.96%	—	0.03%
RWAs (£m)	3,436	236	641	1,867	474	5	32	4	35	—	6,730
RWA density	5.5%	33.8%	14.8%	88.8%	124.1%	33.3%	58.0%	76.3%	524.9%	—	9.6%
Undrawn commitments (£m)	44,902	60	628	1,862	165	1	3	—	—	—	47,621
Undrawn weighted average CCF	0.3%	23.1%	2.5%	7.6%	12.4%	88.1%	101.3%	—	—	—	0.7%

Key points

- Overall exposure to central governments and central banks decreased 34% to £46.5 billion at 31 December 2013 from £70.1 billion at 31 December 2012.
- Almost all of the exposure reduction was in AQ1, primarily due to the sharp fall in cash placements with the Deutsche Bundesbank and partly due to the disposal of US government bonds. This overall decline was slightly offset by a rise in cash placements with the Federal Reserve Bank of New York, in part driven by the proceeds of government bond sales.
- Undrawn commitments in AQ1 fell sharply, reflecting the Group's strategic decision to reduce limits on certain liquidity facilities to levels based on utilisation history.
- The reduction in AQ3 reflects a reduced holding of Japanese government bonds.

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Table 25: Institutions IRB non-counterparty credit risk exposures post CRM by AQ band

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
S&P ratings	AAA to AA	AA-	A+ to A	A- to BBB-	BB+ to BB	BB-	B+ to B	B- to CCC+	CCC to C	D	
EAD post CRM (£m)	2,992	1,568	6,992	9,999	791	105	103	110	1	69	22,730
Exposure-weighted average LGD	27.5%	44.0%	33.4%	64.4%	55.7%	19.0%	21.7%	12.1%	—	86.4%	47.7%
Exposure-weighted average PD	0.03%	0.04%	0.06%	0.18%	0.61%	1.72%	2.87%	8.19%	30.02%	100.00%	0.49%
RWAs (£m)	271	188	931	3,869	587	59	275	57	2	—	6,239
RWA density	9.1%	12.0%	13.3%	38.7%	74.2%	56.2%	267.5%	51.9%	302.6%	—	27.4%
Undrawn commitments (£m)	3,871	3,382	5,445	6,165	1,131	70	39	57	4	1	20,165
Undrawn weighted average CCF	11.2%	2.1%	3.0%	9.1%	11.5%	13.6%	25.2%	47.2%	—	—	7.0%

2012	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	6,807	2,208	4,003	8,920	1,352	128	105	4	1	124	23,652
Exposure-weighted average LGD	14.0%	55.0%	48.2%	56.2%	61.4%	28.1%	34.2%	62.1%	59.4%	82.3%	42.8%
Exposure-weighted average PD	0.03%	0.04%	0.06%	0.20%	0.57%	1.36%	3.94%	13.27%	27.88%	100.00%	0.68%
RWAs (£m)	345	347	844	3,913	1,162	96	196	11	5	—	6,919
RWA density	5.1%	15.7%	21.1%	43.9%	86.0%	75.5%	186.6%	302.6%	354.7%	—	29.3%
Undrawn commitments (£m)	9,551	7,700	12,915	13,317	1,890	83	59	10	11	1	45,537
Undrawn weighted average CCF	5.2%	2.0%	5.6%	8.4%	8.5%	17.0%	7.4%	17.8%	6.3%	101.2%	5.9%

Key points

- Overall exposure to institutions fell by 4% to £22.7 billion at 31 December 2013 from £23.7 billion at 31 December 2012.
- The shift of exposures from AQ1 to AQ3 reflects counterparty downgrade.
- Undrawn commitments in the AQ1 to AQ4 bands fell, due to the Group's decision to reduce limits on certain money market lines to levels based on utilisation history.
- AQ7 RWAs include adjustments associated with implementation of new credit models resulting in high RWA density.

Credit risk

Table 26: Corporates IRB non-counterparty credit risk exposures post CRM by AQ band

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
S&P ratings	AAA to AA	AA-	A+ to A	A- to BBB-	BB+ to BB	BB-	B+ to B	B- to CCC+	CCC to C	D	
EAD post CRM (£m)	37,434	14,867	19,683	25,783	25,289	20,655	13,544	3,545	1,955	20,126	182,881
Exposure-weighted average LGD	37.1%	45.9%	45.5%	43.9%	31.8%	31.5%	30.6%	35.8%	41.4%	64.4%	40.9%
Exposure-weighted average PD	0.03%	0.04%	0.07%	0.20%	0.70%	1.52%	3.32%	9.98%	26.31%	100.00%	12.04%
RWAs (£m)	8,175	4,741	7,490	15,298	18,086	19,034	20,705	5,799	5,030	36	104,394
RWA density	21.8%	31.9%	38.1%	59.3%	71.5%	92.1%	152.9%	163.6%	257.4%	0.2%	57.1%
Undrawn commitments (£m)	56,981	18,436	23,753	18,944	9,763	5,928	4,037	497	416	751	139,506
Undrawn weighted average CCF	24.4%	23.3%	22.1%	24.4%	29.8%	35.9%	39.4%	43.9%	35.9%	52.5%	25.4%

2012	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	38,062	14,253	21,098	30,580	35,163	24,603	16,724	5,429	3,612	28,939	218,463
Exposure-weighted average LGD	28.0%	35.2%	38.6%	35.0%	27.0%	27.5%	32.4%	35.9%	46.9%	62.5%	35.7%
Exposure-weighted average PD	0.03%	0.04%	0.07%	0.21%	0.69%	1.51%	3.50%	10.05%	26.63%	100.00%	14.53%
RWAs (£m)	5,162	2,717	5,883	13,657	21,096	20,217	37,161	8,742	10,299	57	124,991
RWA density	13.6%	19.1%	27.9%	44.7%	60.0%	82.2%	222.2%	161.0%	285.1%	0.2%	57.2%
Undrawn commitments (£m)	58,378	17,374	23,119	20,598	10,106	5,107	4,184	564	372	1,138	140,940
Undrawn weighted average CCF	24.2%	23.6%	23.1%	24.7%	31.3%	38.9%	35.1%	46.2%	48.8%	64.4%	25.9%

Key points

- Corporates exposure decreased 16% to £182.9 billion at 31 December 2013 from £218.5 billion at 31 December 2012.
- A significant portion of the EAD reduction was due to asset disposals, coupled with the maturing of facilities, loan prepayments and amortisations. This was evident across most of the AQ bands.
- The decrease in EAD in AQ4 to AQ7 was largely due to the transition of income-producing real estate (IPRE) customers from the IRB approach to the supervisory slotting approach (refer to the following table).
- The Group will implement a new PD model for its large corporate customers in 2014. The updated calibration associated with this new model, which references over 20 years of rating agency default experience, will result in rating migration from higher to lower quality AQ bands. In excess of £100 billion of EAD, most of it currently reported in AQ1 to AQ4, will migrate by at least one band. The effect of this has been largely reflected in RWAs. Therefore, implementation of the new model will have only a modest RWA impact.

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Table 27: Corporates under the supervisory slotting approach post CRM by AQ category (1)

	Category 1 (strong)	Category 2 (good)	Category 3 (satisfactory)	Category 4 (weak)	Category 5 (defaulted)	Total
2013						
EAD post CRM (£m)	9,028	9,225	3,850	2,165	10,744	35,012
RWAs (£m)	5,905	7,394	4,428	5,413	—	23,140
RWA density	65.4%	80.1%	115.0%	250.0%	—	66.1%
Undrawn commitments (£m)	1,037	758	228	103	347	2,473
Undrawn weighted average CCF	57.0%	66.1%	82.8%	93.1%	79.1%	66.9%
2012						
EAD post CRM (£m)	7,720	6,325	2,255	1,987	3,051	21,338
RWA density	67.3%	80.5%	115.0%	250.0%	—	87.4%
Undrawn commitments (£m)	1,299	502	108	73	74	2,056
Undrawn weighted average CCF	56.9%	55.5%	70.5%	78.1%	77.0%	58.7%

Note:

(1) Customers are split into five supervisory slotting categories; within each category, customers are also divided into two maturity bands: below and above 2.5 years. The risk-weight applied to each exposure is based on a combination of its supervisory slotting category and maturity band. There are no RWAs associated with exposures in category 5 as these are addressed via capital deductions.

Of which: IPRE

2013						
EAD post CRM (£m)	4,388	8,683	3,540	1,958	10,275	28,844
RWA density	62.2%	79.7%	115.0%	250.0%	—	65.1%
Undrawn commitments (£m)	402	730	187	88	262	1,669
Undrawn weighted average CCF	50.8%	66.8%	95.6%	96.2%	75.9%	69.1%
2012						
EAD post CRM (£m)	1,831	5,213	2,005	1,798	2,598	13,445
RWA density	63.9%	79.1%	115.0%	250.0%	—	90.0%
Undrawn commitments (£m)	280	463	86	53	49	931
Undrawn weighted average CCF	30.3%	57.0%	75.7%	80.4%	73.3%	52.9%

Credit risk

Table 27: Corporates under the supervisory slotting approach post CRM by AQ category *continued*

Of which: Project finance

	Category 1 (strong)	Category 2 (good)	Category 3 (satisfactory)	Category 4 (weak)	Category 5 (defaulted)	Total
2013						
EAD post CRM (£m)	4,640	542	310	207	469	6,168
RWA density	68.4%	86.6%	115.0%	250.0%	—	108.8%
Undrawn commitments (£m)	635	28	41	15	85	804
Undrawn weighted average CCF	60.9%	49.1%	24.4%	75.2%	91.1%	62.1%
2012						
EAD post CRM (£m)	5,889	1,112	250	189	453	7,893
RWA density	68.3%	87.0%	115.0%	250.0%	—	82.9%
Undrawn commitments (£m)	1,019	39	22	20	25	1,125
Undrawn weighted average CCF	64.2%	37.7%	49.5%	71.9%	84.0%	63.6%

Key point

- The increase in EAD under the supervisory slotting approach was due to the transition of IPRE customers from the IRB approach to the supervisory slotting approach. Given that the majority of this transitioned exposure was in Category 5 at 31 December 2013, it had no RWAs associated with it and therefore RWA density fell year-on-year.

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Table 28: Retail IRB non-counterparty credit risk exposures post CRM by AQ band

Total retail exposures

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	154	10,310	—	64,128	43,603	19,302	14,723	5,631	4,089	10,187	172,127
Exposure-weighted average LGD	10.6%	42.2%	—	13.1%	21.3%	38.1%	45.7%	44.1%	35.3%	43.8%	25.8%
Exposure-weighted average PD	0.03%	0.04%	—	0.21%	0.63%	1.51%	3.71%	10.51%	39.48%	100.00%	7.93%
RWAs (£m)	—	136	—	2,897	7,047	9,093	13,046	5,765	6,612	7,433	52,029
RWA density	0.2%	1.3%	—	4.5%	16.2%	47.1%	88.6%	102.4%	161.7%	73.0%	30.2%
Undrawn commitments (£m)	3,472	7,500	—	11,612	16,122	5,709	1,235	378	39	323	46,390
Undrawn weighted average CCF	4.4%	100.0%	—	68.3%	34.4%	36.1%	55.5%	86.6%	89.6%	3.8%	52.3%

2012

EAD post CRM (£m)	142	10,992	142	58,350	47,194	18,643	15,744	7,505	4,970	10,731	174,413
Exposure-weighted average LGD	9.2%	35.6%	61.7%	13.3%	20.0%	39.5%	43.1%	47.9%	34.4%	45.3%	26.1%
Exposure-weighted average PD	0.03%	0.04%	0.08%	0.21%	0.65%	1.52%	3.87%	10.30%	38.55%	100.00%	8.46%
RWAs (£m)	—	129	6	2,680	7,204	9,026	14,058	7,865	7,715	7,157	55,840
RWA density	0.2%	1.2%	4.0%	4.6%	15.3%	48.4%	89.3%	104.8%	155.2%	66.7%	32.0%
Undrawn commitments (£m)	3,190	7,674	31	10,361	17,145	4,663	1,250	467	42	321	45,144
Undrawn weighted average CCF	4.4%	100.0%	100.0%	74.0%	31.6%	44.1%	58.0%	80.9%	89.7%	5.3%	53.5%

Of which: Retail SME exposures ⁽¹⁾

2013

EAD post CRM (£m)	—	16	—	1,070	1,713	3,858	1,449	1,125	327	1,799	11,357
Exposure-weighted average LGD	—	—	—	69.7%	37.8%	43.2%	42.3%	45.0%	47.6%	55.4%	47.0%
Exposure-weighted average PD	—	—	—	0.18%	0.84%	1.57%	3.76%	9.98%	37.99%	100.00%	19.08%
RWAs (£m)	—	1	—	318	708	2,421	1,039	1,015	480	768	6,750
RWA density	—	—	—	29.7%	41.3%	62.8%	71.7%	90.4%	147.1%	42.6%	59.4%
Undrawn commitments (£m)	—	9	—	660	172	570	76	87	10	1	1,585
Undrawn weighted average CCF	—	—	—	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

2012

EAD post CRM (£m)	—	—	16	1,139	958	4,755	2,264	1,306	501	1,927	12,866
Exposure-weighted average LGD	—	—	48.4%	70.8%	43.4%	42.8%	41.8%	44.7%	46.4%	56.7%	47.6%
Exposure-weighted average PD	—	—	0.05%	0.17%	0.76%	1.54%	4.01%	10.96%	38.36%	100.00%	18.93%
RWAs (£m)	—	—	1	336	418	2,886	1,589	1,180	709	873	7,992
RWA density	—	—	8.5%	29.5%	43.6%	60.7%	70.2%	90.4%	141.5%	45.3%	62.1%
Undrawn commitments (£m)	—	—	10	723	143	657	136	72	14	—	1,755
Undrawn weighted average CCF	—	—	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	—	100.0%

For the notes to this table refer to page 52.

Credit risk

Table 28: Retail IRB non-counterparty credit risk exposures post CRM by AQ band *continued*

Of which: Retail secured by real estate collateral (2)

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	—	2,681	—	58,746	35,994	10,546	8,868	2,275	3,302	5,903	128,315
Exposure-weighted average LGD	—	8.5%	—	8.6%	13.1%	20.3%	31.3%	13.6%	28.9%	26.3%	13.8%
Exposure-weighted average PD	—	0.04%	—	0.21%	0.62%	1.46%	3.46%	11.33%	39.64%	100.00%	6.45%
RWAs (£m)	—	26	—	2,243	4,596	3,797	7,828	1,598	5,102	5,400	30,590
RWA density	—	1.0%	—	3.8%	12.8%	36.0%	88.3%	70.2%	154.5%	91.5%	23.8%
Undrawn commitments (£m)	—	1,684	—	4,490	3,210	244	57	12	1	11	9,709
Undrawn weighted average CCF	—	100.0%	—	100.0%	89.2%	98.7%	88.5%	100.0%	100.0%	100.0%	96.3%

2012

EAD post CRM (£m)	4	3,739	—	52,819	40,013	8,914	9,617	2,775	3,910	5,917	127,708
Exposure-weighted average LGD	8.0%	8.0%	—	8.4%	12.5%	20.7%	31.4%	14.6%	27.4%	25.7%	13.8%
Exposure-weighted average PD	0.03%	0.04%	—	0.21%	0.65%	1.47%	3.89%	11.54%	38.42%	100.00%	6.75%
RWAs (£m)	—	33	—	1,998	5,053	3,198	9,124	2,016	5,763	4,802	31,987
RWA density	0.9%	0.9%	—	3.8%	12.6%	35.9%	94.9%	72.7%	147.4%	81.2%	25.0%
Undrawn commitments (£m)	2	2,115	—	4,161	2,731	249	52	17	1	16	9,344
Undrawn weighted average CCF	100.0%	100.0%	—	99.9%	90.8%	98.8%	87.1%	99.9%	100.0%	100.0%	97.2%

Of which: Qualifying revolving retail exposures (3)

2013

EAD post CRM (£m)	154	7,613	—	4,302	4,569	3,319	3,252	1,779	320	918	26,226
Exposure-weighted average LGD	10.6%	54.1%	—	59.7%	64.7%	69.2%	74.3%	74.1%	70.3%	76.8%	63.4%
Exposure-weighted average PD	0.03%	0.04%	—	0.24%	0.64%	1.56%	4.13%	9.62%	37.69%	100.00%	5.48%
RWAs (£m)	—	109	—	333	839	1,297	2,766	2,499	728	444	9,015
RWA density	0.2%	1.4%	—	7.8%	18.4%	39.1%	85.0%	140.4%	227.8%	48.4%	34.4%
Undrawn commitments (£m)	3,472	5,806	—	6,462	12,739	4,895	1,102	279	28	311	35,094
Undrawn weighted average CCF	4.4%	100.0%	—	43.0%	19.7%	25.5%	50.7%	81.9%	85.4%	0.1%	37.9%

2012

EAD post CRM (£m)	138	7,253	126	4,299	4,944	3,185	2,846	2,592	367	1,028	26,778
Exposure-weighted average LGD	9.3%	49.8%	63.4%	56.9%	63.6%	66.6%	71.4%	75.9%	70.7%	76.8%	61.5%
Exposure-weighted average PD	0.03%	0.04%	0.08%	0.23%	0.63%	1.58%	3.72%	8.90%	38.23%	100.00%	5.97%
RWAs (£m)	—	96	4	311	892	1,219	2,148	3,534	843	493	9,540
RWA density	0.2%	1.3%	3.4%	7.2%	18.1%	38.3%	75.4%	136.3%	229.4%	48.0%	35.6%
Undrawn commitments (£m)	3,187	5,559	21	5,478	14,270	3,756	1,062	379	27	304	34,043
Undrawn weighted average CCF	4.3%	100.0%	100.0%	50.9%	19.6%	30.7%	51.2%	76.5%	83.8%	0.1%	39.1%

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

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Table 28: Retail IRB non-counterparty credit risk exposures post CRM by AQ band *continued*

Of which: Other retail exposures (4)

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	—	—	—	10	1,327	1,579	1,154	452	140	1,567	6,229
Exposure-weighted average LGD	—	—	—	62.3%	71.7%	78.3%	79.6%	77.4%	77.2%	77.2%	76.8%
Exposure-weighted average PD	—	—	—	0.26%	0.77%	1.63%	4.37%	11.21%	43.30%	100.00%	28.33%
RWAs (£m)	—	—	—	3	904	1,578	1,413	653	302	821	5,674
RWA density	—	—	—	31.4%	68.1%	99.9%	122.5%	144.4%	215.8%	52.4%	91.1%
Undrawn commitments (£m)	—	—	—	—	2	—	—	—	—	—	2
Undrawn weighted average CCF	—	—	—	—	100.0%	—	—	—	—	—	100.0%

2012	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	—	—	—	93	1,279	1,789	1,017	832	192	1,859	7,061
Exposure-weighted average LGD	—	—	—	64.6%	69.3%	76.1%	77.5%	77.0%	74.7%	78.3%	75.6%
Exposure-weighted average PD	—	—	—	0.33%	0.76%	1.59%	3.85%	9.46%	42.37%	100.00%	29.70%
RWAs (£m)	—	—	—	35	840	1,723	1,198	1,135	400	989	6,320
RWA density	—	—	—	38.2%	65.7%	96.3%	117.8%	136.4%	208.9%	53.2%	89.5%
Undrawn commitments (£m)	—	—	—	—	2	—	—	—	—	—	2
Undrawn weighted average CCF	—	—	—	—	100.0%	—	—	—	—	—	100.0%

Notes:

- (1) Consist primarily of loans and overdrafts to SMEs.
- (2) Consist of mortgages.
- (3) Consist primarily of personal credit card and overdraft exposures.
- (4) Consist primarily of unsecured personal loans.

Key points

- Overall, exposures in the retail exposure class fell slightly. This was predominantly due to amortisation and disposals relating to retail SMEs.
- The reduction in the other retail exposures category mainly relates to unsecured loans of up to £25,000 to personal customers. This portfolio has been decreasing in value and volume for several years as repayments and closures have consistently more than offset levels of new business due to tightening lending criteria and competitive pricing.
- The overall retail decline was partially offset by increased exposures in retail secured by real estate collateral. This reflected the moderate growth in UK mortgage business explained earlier.
- Overall, undrawn commitments increased as part of the Group's strategy to provide additional limits to selected low risk credit card customers.

Credit risk

Table 29: Equity exposures calculated using the IRB approach post CRM by AQ band

The exposures represent direct investments or investments in shares traded on an exchange.

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
EAD post CRM (£m)	—	—	—	—	10	120	105	1	26	22	284
Exposure-weighted average LGD	—	—	—	—	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%
RWAs (£m)	—	—	—	—	19	334	347	6	147	—	853
RWA density	—	—	—	—	191.9%	279.4%	329.6%	523.2%	557.9%	—	299.7%

2012

EAD post CRM (£m)	—	—	36	—	196	168	232	1	1	17	651
Exposure-weighted average LGD	—	—	90.0%	—	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%	90.0%
RWA density	—	—	136.0%	—	285.9%	160.5%	285.2%	520.1%	648.4%	—	238.0%

Key points

- The reduction in exposure in AQ5 and AQ7 primarily reflected disposals of equity stakes acquired through Global Restructuring Group restructuring arrangements.
- The small increase in AQ9 and the corresponding decrease in AQ5 were due to a counterparty downgrade.

Table 30: Equity exposures post CRM calculated using the simple risk-weight approach

2013	Exchange traded equity exposures	Private equity exposures	Other equity exposures	Total
EAD post CRM (£m)	306	4	200	510
RWAs (£m)	887	8	738	1,633
RWA density	290.0%	190.0%	370.0%	320.0%
Undrawn commitments (£m)	—	—	30	30
Undrawn weighted average CCF	—	—	100.0%	100.0%

2012

EAD post CRM (£m)	169	120	172	461
RWA density	290.0%	190.0%	370.0%	351.3%
Undrawn commitments (£m)	—	—	30	30
Undrawn weighted average CCF	—	—	100.0%	100.0%

Credit risk

Asset quality analysis of non-counterparty credit risk exposures *continued*

Asset quality of non-counterparty credit risk exposures under the STD approach

Under the STD approach, the Group uses CQS to calculate the RWAs associated with non-counterparty credit risk exposures. Each rated exposure in the STD portfolio is assigned to one of six CQS. The CQS map to the rating of the three major rating agencies, as shown in the table below. Each CQS is associated with a particular risk-weighting. Each exposure is multiplied by the appropriate risk weighting to calculate the relevant RWA amount. If no external rating is available, the Group assigns the exposure a risk-weighting in line with BIPRU.

Table 31: Credit quality steps mapping to external credit gradings

Credit quality step	Standard & Poor's	Moody's	Fitch
Step 1	AAA to AA-	Aaa to Aa3	AAA to AA-
Step 2	A+ to A-	A1 to A3	A+ to A-
Step 3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
Step 4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
Step 5	B+ to B-	B1 to B3	B+ to B-
Step 6	CCC+ and below	Caa1 and below	CCC+ and below

Table 32: Total standardised non-counterparty credit risk exposure by credit quality step

The following table analyses the asset quality of the Group's non-counterparty credit risk exposures using the STD approach. For these exposures, the asset quality is disclosed according to CQS, as defined in Table 31.

STD exposure class	Credit quality step						Unrated exposure £m	Total £m
	Step 1 £m	Step 2 £m	Step 3 £m	Step 4 £m	Step 5 £m	Step 6 £m		
2013								
Central governments and banks	67,647	—	4	—	—	—	5	67,656
Regional governments or local authorities	425	—	64	—	—	—	12	501
Administrative bodies and non-commercial undertakings	50	—	—	—	—	—	—	50
Multilateral development banks	19	—	—	—	—	—	—	19
Institutions	649	1,056	4	1	—	—	194	1,904
Corporates	6,405	526	2,145	1,813	1,131	69	34,563	46,652
Covered bonds	107	—	—	—	—	—	—	107
Collective investment undertakings	—	—	—	24	—	—	—	24
Retail	—	—	—	—	—	—	22,833	22,833
Secured by mortgages on								
- commercial real estate	2	—	—	—	—	—	4,772	4,774
- residential property	—	—	—	—	—	—	21,290	21,290
Past due items	—	—	—	—	—	—	1,199	1,199
Securitisation positions	908	224	10	32	—	—	—	1,174
Other items	611	156	164	96	22	6	966	2,021
Total EAD post CRM	76,823	1,962	2,391	1,966	1,153	75	85,834	170,204
Total EAD pre CRM	76,821	1,962	2,426	1,966	1,153	76	87,591	171,995

Credit risk

Table 32: Total standardised non-counterparty credit risk exposure by credit quality step *continued*

STD exposure class 2012	Credit quality step						Unrated exposure £m	Total £m
	Step 1 £m	Step 2 £m	Step 3 £m	Step 4 £m	Step 5 £m	Step 6 £m		
Central governments and banks	51,706	—	243	—	1	—	5	51,955
Regional governments or local authorities	1,472	15	41	18	—	—	23	1,569
Administrative bodies and non-commercial undertakings	61	—	4	—	—	—	—	65
Multilateral development banks	3	—	—	—	—	—	—	3
Institutions	570	3,112	122	2	—	—	261	4,067
Corporates	7,251	547	2,026	1,552	886	46	36,173	48,481
Retail	—	—	—	—	—	—	26,658	26,658
Secured by mortgages on								
- commercial real estate	6	—	—	—	11	—	7,419	7,436
- residential property	1	—	—	—	—	—	20,672	20,673
Past due items	—	—	—	—	—	—	1,643	1,643
Securitisation positions	179	24	26	33	—	—	—	262
Other items	820	145	145	60	21	—	750	1,941
Total EAD post CRM	62,069	3,843	2,607	1,665	919	46	93,604	164,753
Total EAD pre CRM	62,068	3,843	2,608	1,716	919	46	95,241	166,441

Key points

- Overall EAD post CRM increased 3% to £170.2 billion at 31 December 2013 from £164.8 billion at 31 December 2012.
- The most significant increase was in CQS1. This was driven by the increase in cash placements with the Bank of England due to excess sterling liquidity during the year.
- The reduction in unrated exposures was mainly due to a decline in the home equity loan portfolio and home equity lines of credit in the US, as amortisation outpaced new business.
- A number of existing securitised exposures are now reported as capital deductions instead of RWAs and so the underlying portfolios are no longer reported against the corporate exposure class under the STD approach.

Expected loss and impairment

The table below shows the expected loss (EL) predicted for the following year at 31 December 2012 and 31 December 2011, and the impairment charges recorded for each of the subsequent years. It includes expected losses both for assets that have already defaulted (and for which an impairment was recognised where appropriate under IFRS) and for assets that were still performing at the year end.

Expected loss is calculated by applying the Group's PD, LGD and EAD models to its portfolios. The Group's PD models incorporate differing degrees of through-the-cycle (TTC) and point-in-time (PIT) characteristics depending on the portfolio.

The impairment charge is the amount recorded in the income statement. The Group's accounting policy on impairments is set out on pages 382 and 383 of the Group's 2013 Annual Report and Accounts.

The methodologies and underlying principles used to calculate expected loss in accordance with regulatory requirements differ significantly from those followed for the recognition of impairments under financial reporting standards. Impairments are typically calculated where a loss has occurred (for example, under the IFRS incurred loss model). An expected loss is a forward-looking measure that is applied to all assets regardless of whether a loss has been incurred.

Key differences include the following:

- **Timing** - For the period between a default and the associated asset being written-off or recovered, an expected loss is calculated according to regulatory requirements, while some or all of the associated impairment may already be recognised in the income statement.
- **Cyclicality** - For PD models with predominantly TTC characteristics (notably wholesale models), expected loss does not, by definition, produce a result that aligns with actual loss experience in every one year period.

For regulatory capital purposes, as at 31 December 2013, the amount by which expected loss exceeds cumulative impairment provisions is deducted from capital. 50% is deducted from Core Tier 1 capital and 50% from Tier 2 capital.

Credit risk

Expected loss and impairment *continued*

Table 33: Expected loss and impairment charge

IRB exposure class	Expected loss predicted for following year at the end of								Impairment charge for the year	
	2012				2011				2013	2012
	Non-defaulted (AQ1-AQ9) £m	Defaulted (AQ10) £m	Total £m	EL/EAD %	Non-defaulted (AQ1-AQ9) £m	Defaulted (AQ10) £m	Total £m	EL/EAD %		
Central governments and banks	8	—	8	—	3	1,243	1,246	1.0	—	—
Institutions	19	102	121	0.2	21	116	137	0.2	(9)	24
Corporates	1,324	19,619	20,943	8.0	1,675	20,384	22,059	7.0	7,167	3,277
Retail										
- SMEs	229	1,015	1,244	10.0	304	994	1,298	9.0	173	206
- secured by real estate collateral	677	1,136	1,813	1.0	731	711	1,442	1.0	228	738
- qualifying revolving retail exposure	409	746	1,155	4.0	472	781	1,253	5.0	203	401
- other retail exposures	181	1,376	1,557	22.0	226	1,473	1,699	21.0	329	201
Equities	51	15	66	6.0	39	45	84	7.0	—	—
	2,898	24,009	26,907	4.0	3,471	25,747	29,218	4.0	8,091	4,847

Key points

- At 31 December 2012, the expected loss was £26.9 billion whereas the impairment charge for the following year was £8.1 billion. The majority of expected loss at 31 December 2012 and 31 December 2011 related to already defaulted assets, for which impairment provisions had already been made. This difference and the cumulative impairment provisions to that date had already been absorbed into the Group's regulatory capital and were reflected in the Group's capital ratios through capital deductions.
- The year-on-year increase in impairment charge in the corporates exposure class was not reflected in the expected loss values owing to the additional RBS Capital Resolution (RCR) impairment charge of £4.5 billion. This increased impairment charge reflected the revised strategy to run down high-risk loans faster, a development that was not anticipated in the models used to calculate expected loss.
- Aside from this significant feature, year-on-year trends were consistent with the broadly improving trend in the Group's portfolios.
 - Expected losses and impairment charges excluding RCR were lower year-on-year across the corporate and retail exposure classes, reflecting both improved credit quality and portfolio reductions, particularly in the case of the corporates exposure class where EAD was 17% lower year-on-year.
 - Expected loss on non-defaulted exposures was higher in the central governments and banks and institutions exposure classes because of the recalibration of PD and LGD models in 2012.

Probability of default and exposure at default

Wholesale credit grading models are hybrid models. They exhibit a degree of cyclicity that reflects broader credit conditions, but not the full cyclicity of a more PIT methodology.

The following table shows the estimated PD at the beginning of the past two years, compared with the actual default rate realised during the year. For wholesale exposures, the PD shown is the average counterparty PD. For retail exposures, it is the average account level PD. Exposures in default at the start of the year are excluded as their probability of default is 100%. The default rate is the number of defaults observed during the year, divided by the number of obligors or accounts at the start of the year.

The EAD ratio displayed represents the total predicted model EAD at the end of the previous year, against the actual exposure at the time of default for all assets that defaulted during the year.

As at the reporting date, the Group had substantially completed the transition of IPRE exposures to the supervisory slotting approach, with residual exposures expected to transition in early 2014. For this reason, exposures that would have been subject to the slotting approach have been excluded from the PD disclosure as RWAs are no longer a function of their PD estimates. Prior year values have been revised to reflect this. EAD is unaffected as, where relevant, EAD models continue to be applied to exposures subject to the slotting approach.

For wholesale portfolios, the following table also reflects an enhanced definition of the population of defaults included in the disclosure. This aligns more closely with the data used internally for modelling purposes, as it removes default events resulting from administrative issues rather than credit risk outcomes, for example, when a customer is temporarily delinquent owing to an administrative incident that is resolved in a short period of time. Prior PD data have been revised so that data are presented on a consistent basis. The impact on reported EAD is immaterial.

Credit risk

Table 34: Predicted probability of default, actual default rates and EAD outcomes versus predictions

	PD				EAD	
	Estimate at 2012 %	Actual 2013 %	Estimate at 2011 %	Actual 2012 %	Estimate to actual ratio 2013 %	Estimate to actual ratio 2012 %
IRB exposure class						
Central governments and banks	0.92	—	0.30	—	—	—
Institutions	0.60	—	0.50	0.07	—	106
Corporates	2.18	2.60	2.18	2.62	109	115
Retail						
- SMEs	3.77	2.84	3.94	3.43	110	107
- secured by real estate collateral	2.11	1.28	2.42	1.89	102	101
- qualifying revolving retail exposures	1.97	1.81	2.20	1.95	112	104
- other retail exposures	4.22	3.75	4.31	4.24	109	109
Equities	2.89	1.31	3.25	3.11	—	—

Key points

- The change in default rates reflect an improvement in credit quality across portfolios.
- In the corporates exposure class, the broadly stable year-on-year actual default rate reflected a combination of reducing default rates in Core portfolios, almost offset by increased default rates in Non-Core and Ulster Bank.
- The decline in actual default rates in relation to retail secured by real estate collateral reflected improving trends in both UK Retail and Ulster Bank.
- In the corporates exposure class, actual default rates continued to exceed estimated PD. In future years, the reverse is likely to be the case, as a consequence of the implementation of a recalibration of the model used for mid-corporate customers in the Group's businesses in the UK and the Republic of Ireland. The recalibration was not yet fully implemented at 31 December 2013 and will be completed in early 2014. Hence, its impact is not reflected in the figures reported. As the RWA impact of this recalibration was reflected in 2012, implementation of the change will have no further impact on RWAs.
- For the four retail exposure classes, the year-on-year declines in the PD estimates were driven by regular model recalibrations undertaken to reflect the most recent actual default rates.

Loss given default

In the corporates exposure class, actual LGD includes all defaulted cases that closed during the year. Closure of a case comprises either the write-off of a debt, the return of a debt to the performing book, or a combination of the two, as in the case of a partial write-off. Central governments and banks, institutions and equities are not included owing to nil or very low volumes, making disclosure not meaningful.

In the retail exposure classes, LGD models are used to estimate losses over defined periods ranging from 36 to 72 months, to align with the collections and recoveries process. The actual losses included in the table below relate to defaulted exposures with outcomes observed during the relevant reporting period. LGD estimated and actual are EAD-weighted.

In the following table, actual LGD for the year is compared with pre-default estimated LGD, on the same population of cases that closed (in the case of the corporates class) or were observed (in the case of the retail classes) during the year. This differs from prior year disclosures, which reported estimated LGD across the total portfolio, both defaulted and non-defaulted, at the beginning of the year. The prior year estimate has been revised to be on a consistent basis with the current year.

Exposures that would have been subject to the slotting approach have been excluded from the LGD disclosure as RWAs are no longer a function of LGD estimates. Prior year values for the corporates exposure class have been revised to reflect the same exclusion.

Credit risk

Loss given default *continued*

Table 35: Loss outcomes versus predictions

IRB exposure class	2013		2012	
	LGD - estimated %	LGD - actual %	LGD - estimated %	LGD - actual %
Corporates	42.5	28.2	45.7	23.3
Retail				
- SMEs	53.9	40.4	55.9	41.1
- secured by real estate collateral	18.6	10.7	17.6	13.5
- qualifying revolving retail exposures	76.4	75.8	76.2	77.6
- other retail exposures	81.0	76.5	82.5	79.4

Key points

- Loss outcomes were generally stable year-on-year.
- In the corporates exposure class, losses on cases in the process of being resolved or written-off continued to be on average lower than those in the wider defaulted portfolio, as evidenced by a comparison to provision coverage rates.
- In all exposure classes, estimated LGDs exceeded actual values, reflecting appropriately prudent estimates.

Counterparty credit risk

Counterparty credit risk relates to OTC derivative and repo contracts in either the trading or the non-trading book. It is the risk of loss arising from a default of a customer before the final settlement of the transaction's cash flows, which vary in value by reference to a market factor, such as an interest rate, exchange rate or asset price.

Counterparty credit risk is covered by the Group's credit risk framework. However, a number of specific policies apply to OTC derivative and repo products. These include policies that address documentation requirements, product-specific requirements (for example, equity, futures, credit derivatives and securities lending), counterparty specific requirements (for example, hedge funds and pension funds), margin trading, collateral and custodians.

Exposure calculation methods

Internal model method

Where granted approval by the PRA, the Group uses IMMs for regulatory capital calculations relating to both OTC derivatives and securities financing transactions.

For OTC derivatives, the IMM calculates EAD as the product of effective expected positive exposure and an alpha factor. The alpha factor quantifies the extra capital needed to reflect the institution specific characteristics of counterparty credit risk exposures.

During 2013, the Group significantly increased the scope, ability and accuracy of its models to calculate counterparty credit risk on OTC derivative transactions. As a result, in the fourth quarter of 2013, the PRA approved the Group's use of the enhanced models for this purpose. This approval is formalised through the IMM waiver, which specifies the products and legal entities for which the Group can calculate capital using these models as well as the alpha factor to be used.

The greater product coverage resulting from the expanded IMM waiver allows for more netting benefits and enhanced exposure modelling. As a result, the PRA has granted the Group approval to use a reduced alpha of 1.4 for 2013 compared with 2.0 for 2012.

The Group has also introduced a new collateral model to accommodate the capital calculation models. This allows collateral to be modelled more consistently than the previous model.

In combination, the new models and greater product coverage under the IMM waiver, the new collateral model and the reduced alpha have had a significant downward impact on the EAD and RWAs (£14.3 billion in RWA terms) associated with the Group's OTC derivative transactions.

For securities financing transactions, as at 31 December 2013, the IMM used was repo VaR, which has two main components:

- An unsecured exposure amount (known as 'expected exposure'), which is a sum of the difference between the exposure to, and the collateral held for, a counterparty across all positions, while taking into account counterparty master netting agreements; and
- A potential change in value amount, calculated using the Group's internal daily VaR model at a 99th percentile confidence interval.

Mark-to-market (mtm) method

Where the Group has not been granted approval by the PRA to use the IMM for regulatory capital purposes, it calculates counterparty credit risk exposures using the mtm method. Exposure is calculated as the positive mtm value of outstanding contracts plus an additional potential future exposure that varies according to the transaction.

The following table details counterparty credit risk exposures post CRM by regulatory approach, exposure calculation method and product type. For an analysis of counterparty RWAs and minimum capital requirements, refer to Tables 1, 12, 14 and 16.

Credit risk

Table 36: Counterparty credit risk exposures post CRM by regulatory approach, exposure calculation method and product type

Product type	2013			2012		
	Mark-to-market method £m	Internal model method £m	Total £m	Mark-to-market method £m	Internal model method £m	Total £m
<i>IRB approach</i>						
OTC derivatives	20,450	23,263	43,713	50,851	35,095	85,946
Securities financing transactions	17,506	1,330	18,836	19,751	3,863	23,614
	37,956	24,593	62,549	70,602	38,958	109,560
<i>STD approach</i>						
OTC derivatives	896	294	1,190	1,273	583	1,856
Securities financing transactions	6,072	209	6,281	9,246	167	9,413
	6,968	503	7,471	10,519	750	11,269
	44,924	25,096	70,020	81,121	39,708	120,829

Key points

- Total counterparty credit risk EAD post CRM fell to £70.0 billion at 31 December 2013 from £120.8 billion at 31 December 2012. The main drivers of the decline were:
 - the Group's new IMM waiver for OTC derivatives;
 - an upward shift in interest rate swap curves across all major currencies including sterling, the US dollar and the euro. In its interest rate swap arrangements, the Group generally received interest at a higher fixed rate but paid a lower floating rate. The net result was an overall reduction in the gap between interest received and paid, driving down EAD;
 - a decrease in trading volumes as trades matured; and
 - the reduction in exposure to securities financing transactions given lower trading book liquidity placements with the Bank of England.

Credit risk

Counterparty credit risk *continued*

Table 37: Counterparty credit risk EAD by AQ band under the IRB approach

2013	AQ1	AQ2	AQ3	AQ4	AQ5	AQ6	AQ7	AQ8	AQ9	AQ10/default	Total
S&P ratings	AAA to AA	AA-	A+ to A	A- to BBB-	BB+ to BB	BB-	B+ to B	B- to CCC+	CCC to C	D	
EAD post CRM (£m)	28,448	7,609	10,073	7,376	2,262	574	934	57	199	675	58,207
Exposure-weighted average LGD	36.3%	48.9%	45.9%	57.0%	53.1%	41.0%	46.0%	35.7%	60.0%	65.7%	43.5%
Exposure-weighted average PD	0.02%	0.04%	0.07%	0.20%	0.67%	1.49%	2.88%	9.46%	21.67%	100.00%	1.38%
RWAs (£m)	2,862	1,805	2,677	4,135	2,241	628	1,114	89	737	2	16,290
RWA density	10.1%	23.7%	26.6%	56.0%	99.1%	109.4%	119.4%	155.9%	370.8%	0.2%	28.0%
2012											
EAD post CRM (£m)	39,584	15,760	21,298	14,866	4,921	1,959	1,767	252	1,340	1,333	103,080
Exposure-weighted average LGD	34.8%	50.8%	45.6%	43.6%	44.9%	38.8%	33.2%	44.6%	53.8%	55.8%	41.8%
Exposure-weighted average PD	0.02%	0.04%	0.07%	0.20%	0.66%	1.44%	2.88%	9.13%	25.65%	100.00%	1.81%
RWAs (£m)	4,105	3,785	6,727	6,684	5,168	2,903	2,410	446	5,500	10	37,738
RWA density	10.4%	24.0%	31.6%	45.0%	105.0%	148.2%	136.5%	176.9%	410.4%	0.7%	36.6%

Key points

- Overall EAD post CRM for counterparty credit risk declined to £58.2 billion at 31 December 2013 from £103.1 billion at 31 December 2012, largely driven by the new IMM waiver for OTC derivatives implemented by the Group, as detailed on page 58.
- The decreases in EAD in the AQ1 to AQ3 bands were also driven by the decrease in trading volumes and the upward shift in interest rate swap curves.

Credit risk

Counterparty credit limit setting

Counterparty credit limits are established through the Group's credit risk management framework. Limits are based on the credit quality of the counterparty and the appetite for the projected maximum potential future exposure of anticipated derivative transactions, based on 95th percentile confidence levels. They also reflect the nature of the relevant documentation.

Counterparty credit risk management

The Group credit policy framework governs counterparty credit risk management requirements. The legal and administrative capacity of derivative counterparties to enter into collateral agreements is assessed. The policy framework establishes minimum documentation requirements under collateral agreements including: unsecured thresholds; minimum transfer amounts; minimum haircuts; collateral eligibility criteria; and collateral call frequency. Where netting and/or collateral enforceability criteria are not fulfilled, exposure is assumed to be uncollateralised. Appropriate derivative documentation is executed for clients prior to trading. Exceptions to this require specific approval from a senior risk officer. The framework also includes a formal escalation policy for counterparty collateral disputes and unpaid collateral calls.

The risk mitigating impact of netting and collateralisation on the counterparty credit risk relating solely to OTC derivatives under the mtm method is shown in the following table. Owing to the model structure, netting benefits cannot be provided for OTC derivatives under the IMM approach.

Table 38: Netting and collateralisation impact on counterparty credit risk for OTC derivatives under the mtm method

Counterparty credit risk	2013 £m	2012 £m
Positive gross mtm value of contracts plus potential future credit exposure	68,306	238,670
Netting benefits	(35,659)	(165,914)
Net current credit exposure plus potential future credit exposure	32,647	72,756
Collateral held	(11,301)	(20,631)
Exposure at default post CRM	21,346	52,125

Key points

- As a result of the application of the new IMM waiver for OTC derivatives, the scope of the IMM has increased and that of the mtm method has thus decreased. This, together with decreased trading volumes, has significantly driven down the gross positive fair value of contracts. This was further driven by a lower mtm as a result of increases across all major swap curves as detailed in the commentary on Table 36.
- Netting benefits under the mtm method declined by 79%, broadly in line with the 71% reduction in the gross positive fair value of contracts.
- Collateral held fell 45%, a shallower decline than that seen in the gross positive fair value of OTC contracts. This reflects the Group's ongoing focus on risk mitigation opportunities.

Credit risk

Counterparty credit risk *continued*

Collateral required in the event of a credit rating downgrade

The Group calculates the additional collateral it would be required to post in the event of its credit ratings being downgraded by one or two notches. This is undertaken on a daily basis for treasury and liquidity management purposes. For further information, refer to pages 212 and 529 of the Group's 2013 Annual Report and Accounts.

Credit valuation adjustments

A credit valuation adjustment (CVA) represents an estimate of the adjustment to the fair value of a derivative contract that a market participant would make, to incorporate any credit risk inherent in counterparty derivative exposures. CVAs for monoline insurance companies are calculated on a trade-by-trade basis, using market observable credit spreads. The methodology used for credit derivative product companies is similar although, in the absence of market observable credit spreads, it estimates the cost of hedging expected default losses in excess of the capital available in each vehicle. For all other counterparties, CVAs are calculated either on a trade-by-trade basis reflecting the estimated cost of hedging the risk through credit derivatives, or on a portfolio basis, reflecting an estimate of the amount the third party would have to pay to assume the additional credit risk.

The counterparty exposure management (CEM) team charges the relevant trading desk a credit premium at the inception of a trade, in exchange for taking on the credit risk over the life of the transaction. CEM may then hedge the credit risk and default sensitivities using interest rate swaps, foreign exchange and other credit derivatives from third party providers.

Credit derivatives

As part of its credit risk strategy to manage credit risk concentrations, the Group buys credit derivative products. The counterparties from which the Group buys this protection are subject to standard credit risk analysis. Eligibility criteria apply: credit protection bought from the same corporate group as the reference entity is not eligible credit protection. A summary of the notional principal amount of credit derivative transactions is detailed in the following table, split between protection bought for portfolio management purposes and that relating to intermediation in the credit derivative markets. Disclosures on credit derivatives are included on pages 298 and 299 of the Group's 2013 Annual Report and Accounts.

Table 39: Credit derivative transactions

	2013		2012	
	Credit default swaps £m	Total return swaps £m	Credit default swaps £m	Total return swaps £m
Notional principal amount of credit derivative transactions				
Used for own credit portfolio - protection bought	2,331	—	5,417	—
Used for intermediation activities - protection bought	132,503	310	282,972	921
Used for intermediation activities - protection sold	116,128	1,171	262,702	798
	250,962	1,481	551,091	1,719

Key point

- The overall reduction in credit default swaps was primarily driven by the Group's strategy to dispose of positions and by reduced trading volume.

Wrong-way risks

Wrong-way risk represents the risk of loss that arises when the risk factors driving the exposure to a counterparty are positively correlated with the probability of default of that counterparty, i.e. the size of the exposure increases at the same time as the risk of the counterparty being unable to meet that obligation increases.

In addition to its usual credit approval and credit authority policies, which are explained on pages 228 to 230 of the Group's 2013 Annual Report and Accounts, the Group also manages its exposure to wrong-way risk through a dedicated policy that establishes a framework incorporating approvals, controls, limits and regular monitoring, where appropriate.

Under the framework, enhanced transaction approval is required and limits are set to constrain wrong-way risk arising through currency exposure to countries classified as high-risk under the Group's internal Watchlist process. The reporting process includes a monthly review of wrong-way risks arising either from such currency exposure or through reverse repos, credit derivatives and equity trades.

The framework distinguishes between specific wrong-way risk (where the risk factor driving the exposure is specific to the counterparty) and general wrong-way risk (where the risk factor driving the exposure is not specific to the counterparty but still positively correlated with its probability of default, for instance country or currency related factors).

Credit risk

Past due and impaired assets

A credit exposure is past due when its contractual repayment is overdue by 90 days or more.

A loan is impaired and an impairment loss is incurred when there is objective evidence that events since the loan was granted have adversely affected expected cash flows from the loan. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows discounted at the loan's original effective interest rate.

For more details on impairment loss provisioning refer to page 250 of the Group's 2013 Annual Report and Accounts.

Disclosure basis

The following tables detailing past due and impaired assets and provisions are presented on an IFRS basis rather than on a regulatory basis.

Table 40: Past due exposures, impaired exposures and provisions by industry sector for Group and significant subsidiaries

Industry sector	Impaired assets (1) £m	Past due assets £m	Individually and collectively assessed provisions £m	Latent provisions £m	Total provisions £m	Charge to income statement (2) £m
2013						
Agriculture and fisheries	179	27	107		107	98
Building and construction	1,245	97	781		781	298
Business services	1,493	62	1,010		1,010	189
Financial services	807	119	545		545	5
Manufacturing	754	13	576		576	199
Individuals	7,720	722	3,708		3,708	807
Power and water	131	—	80		80	54
Property	19,442	833	13,182		13,182	5,123
Public sector and quasi-government	1,174	152	758		758	361
Telecoms, media and technology	316	1	236		236	198
Tourism and leisure	1,339	88	812		812	281
Transport and storage	1,439	52	635		635	487
Wholesale and retail trade	1,132	55	783		783	268
Latent				2,003	2,003	44
	37,171	2,221	23,213	2,003	25,216	8,412
2012						
Agriculture and fisheries	157	20	73		73	21
Building and construction	1,362	121	640		640	94
Business services	1,805	76	1,103		1,103	280
Financial services	1,147	21	725		725	212
Manufacturing	743	46	372		372	136
Individuals	8,910	542	4,233		4,233	1,579
Power and water	118	—	21		21	(4)
Property	19,934	1,289	9,859		9,859	2,212
Public sector and quasi-government	1,030	160	521		521	144
Telecoms, media and technology	72	—	37		37	19
Tourism and leisure	1,486	111	726		726	176
Transport and storage	653	181	336		336	289
Wholesale and retail trade	1,069	74	644		644	230
Latent				1,960	1,960	(73)
	38,486	2,641	19,290	1,960	21,250	5,315

Notes:

(1) Excludes debt securities and equity shares totalling £537 million (2012 - £942 million).

(2) Excludes impairment losses on debt securities and equity shares totalling £20 million (2012 - £(36) million).

Credit risk

Past due and impaired assets *continued*

Table 40: Past due exposures, impaired exposures and provisions by industry sector for Group and significant subsidiaries *continued*

	Group £m	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	RBS Citizens Financial Group £m
2013						
Impaired assets (1)	37,171	36,905	23,787	19,212	259	1,324
Past due assets	2,221	2,221	1,277	226	—	—
Individually and collectively assessed provisions	23,213	23,056	16,771	13,834	152	245
Latent provisions	2,003	1,989	1,201	933	11	273
Total provisions	25,216	25,045	17,972	14,767	162	518
Charge to income statement (2)	8,412	8,465	5,405	4,794	(32)	307
2012						
Impaired assets (1)	38,486	37,887	23,767	18,219	412	1,564
Past due assets	2,641	2,637	1,668	630	—	—
Individually and collectively assessed provisions	19,290	18,886	13,262	9,962	249	287
Latent provisions	1,960	1,921	1,129	812	29	255
Total provisions	21,250	20,807	14,391	10,774	278	542
Charge to income statement (2)	5,315	5,281	3,177	2,340	24	260

Notes:

- (1) Excludes debt securities and equity shares totalling: RBS Consolidated £375 million (2012 - £584 million); NatWest Consolidated £42 million (2012 - £57 million); Ulster Bank Group £11 million (2012 - £9 million); RBS N.V. £nil million (2012 - £nil million); and RBS Citizens Financial Group £nil million (2012 - £nil million).
 (2) Excludes debt securities and equity shares totalling RBS Consolidated £16 million (2012 - £67 million); NatWest Consolidated £2 million (2012: £6 million); Ulster Bank Group £nil million (2012 - £nil million); RBS N.V. £29 million (2012 - £39 million); and RBS Citizens Financial Group £5 million (2012 - £8 million).

Table 41: Past due exposures, impaired exposures and provisions by geographic area

Geographic area (1)	Impaired assets (2) £m	Past due assets £m	Individually and collectively assessed provisions £m	Latent provisions £m	Total provisions £m	Charge to income statement (3) £m
2013						
UK	17,481	1,962	10,390		10,390	3,656
Europe	17,817	259	12,238		12,238	4,340
North America	1,475	—	324		324	330
RoW	398	—	261		261	42
Latent				2,003	2,003	44
	37,171	2,221	23,213	2,003	25,216	8,412
2012						
UK	18,413	2,007	9,082		9,082	2,420
Europe	17,817	633	9,500		9,500	2,456
North America	1,719	—	402		402	490
RoW	537	1	306		306	22
Latent				1,960	1,960	(73)
	38,486	2,641	19,290	1,960	21,250	5,315

Notes:

- (1) The analysis by geographic area is based on the location of the lender. This analysis is used for financial reporting and differs from Tables 13 and 17 which are based on the country of operation of the counterparty.
 (2) Excludes debt securities and equity shares totalling £537 million (2012 - £942 million).
 (3) Excludes impairment losses on debt securities and equity shares totalling £20 million (2012 - £(36) million).

Credit risk

Table 42: Loan impairment provisions movement

	Individually assessed provisions (1) £m	Collectively assessed provisions £m	Latent provisions £m	Total provisions £m
At 1 January 2012	12,757	5,140	1,986	19,883
Transfer from disposal groups	153	548	63	764
Currency translation and other adjustments	(506)	211	(15)	(310)
Disposals	(4)	—	(1)	(5)
Amounts written-off	(2,633)	(1,633)	—	(4,266)
Recovery of amounts previously written-off	122	219	—	341
Charge to income statement				
- continuing operations (2)	3,192	2,196	(73)	5,315
- discontinued operations	4	—	—	4
Unwind of discount	(336)	(140)	—	(476)
At 31 December 2012	12,749	6,541	1,960	21,250
Transfer from disposal groups	—	—	(9)	(9)
Currency translation and other adjustments	77	36	8	121
Disposals	(4)	(73)	—	(77)
Amounts written-off	(2,652)	(1,694)	—	(4,346)
Recovery of amounts previously written-off	95	161	—	256
Charge to income statement				
- continuing operations (2)	6,904	1,464	44	8,412
Unwind of discount	(260)	(131)	—	(391)
At 31 December 2013	16,909	6,304	2,003	25,216

Notes:

(1) Includes provisions against loans and advances to banks.

(2) Excludes impairment losses on securities totalling £20 million (2012 - £(36) million).

Securitisation

This section presents descriptive information on the Group's securitisation activities and related risk management processes and accounting policies, followed by quantitative disclosures on its exposures to securitisations.

Definitions

Securitisation and structured entities

Securitisation is the process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity (SE), which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income generating assets (ranging from trade receivables to residential mortgage loans).

SEs are set up for a specific limited purpose. They do not usually provide a commercial service or employ staff. SEs, including those used for securitisation purposes, may take a variety of legal forms, such as trusts, partnerships and companies. Typically, their share capital is held ultimately by charitable trusts.

Securitisations can broadly take two forms: traditional and synthetic. In traditional securitisations, an originating bank transfers ownership of a pool of assets to an arm's length SE. In synthetic securitisations, the originating bank retains ownership of a pool of assets, but transfers the associated credit risk to an arm's length SE through the use of credit-linked notes or credit derivatives.

Note that, although SEs are frequently used, they are not necessarily required for all securitisation structures.

The following definitions are used in these Pillar 3 disclosures:

Trading book - In this section, the trading book consists of positions in financial instruments and commodities held either with the intent to trade or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any covenants restricting their tradability or be able to be hedged.

Non-trading book - The non-trading book consists of positions, exposures, assets and liabilities that are not in the trading book. It is also referred to as the 'banking book'. In this section, the counterparty credit risk arising from derivative trades associated with securitisation SEs is captured in the non-trading book disclosures.

Securitisation position - Any exposure the Group may have to a securitisation. This includes not only exposures arising from the purchase or retention of the securities issued by a securitisation SE but also loans and liquidity facilities to securitisations, and the counterparty credit risk exposure of derivative positions transacted with a securitisation.

Re-securitisation - A securitisation in which the underlying asset or pool of assets comprises at least one securitisation position.

Securitised exposure - An asset or pool of assets that is securitised by way of a traditional or synthetic securitisation.

Significant risk transfer assessment - An assessment prescribed by BIPRU and designed to determine whether or not a securitisation structure effectively transfers the risks of the assets to a party or parties other than the originator.

Term securitisation - A securitisation vehicle funding a pool of assets through the issuance of long-term securities. A term securitisation may hold the assets of one or more originators.

Asset-backed commercial paper (ABCP) conduit - A securitisation vehicle funding a pool of assets through the issuance of predominantly short-term securities (namely commercial paper). A conduit may hold the assets of one or more originators (referred to as a single-seller or multi-seller conduit, respectively), one of which may also be the sponsor.

Objectives and roles

By participating in securitisation activity, the Group aims to achieve one or more of the following objectives:

- To diversify its sources of funding, either for the Group or for customers;
- To facilitate prudential balance sheet and credit risk management, either for the Group or customers; and
- To earn fees for its provision of liquidity lines to customers' conduit assets.

In doing so, the Group may incur a range of risks, including credit (non-counterparty and counterparty), market, liquidity and funding, legal, regulatory and reputational risks for which it must hold regulatory capital. For details of BIPRU rules governing the calculation of regulatory capital required in respect of securitisations, refer to pages 68 and 69.

The Group may play one or more of the following roles in a securitisation transaction:

Originator - To diversify its sources of funding and manage its balance sheet, the Group securitises assets it has purchased or created. The origination of securitisation assets may expose the Group to credit risk, both non-counterparty and counterparty, and market risk, particularly if the structure of the transaction does not transfer these risks to others. Even if it does, the Group may nevertheless be exposed to these risks if it retains a securitisation position by, for example, providing the SE with a liquidity facility.

Investor - To generate financial returns, the Group may:

- purchase securities issued by an SE;
- enter into derivative transactions with an SE; or
- lend to an SE, often by providing a back-up liquidity facility that the SE can use if it is unable to issue securities, particularly commercial paper. Investment in securitisations exposes the Group to market risk and credit risk, both non-counterparty and counterparty.

Securitisation

To generate additional fee income, the Group may play other roles as well:

Sponsor - The Group may establish and manage an ABCP conduit or term securitisation that purchases bonds or other financial assets from third parties. It may do so on its own account or on behalf of its customers. In its role as sponsor, the Group is particularly exposed to credit and liquidity risk.

Arranger - The Group may structure a securitisation transaction, drafting the documentation that governs the behaviour of the SE, and then sell the securities issued by the SE to investors. The Group may act as arranger for securitisation transactions it originates or, alternatively, for securitisation transactions originated by its customers, principally large corporates.

Manager - The Group may manage the securitisation as required by the terms of the transaction. This may, for example, entail rebalancing the asset pool as and when necessary.

Underwriter - The Group may underwrite the securities issued by an SE. The associated securitisation transaction may be originated by the Group or its customers.

Other administrative roles - As a 'contractual party', the Group may do any of the following, alone or in combination:

- hold the bank account of an SE on its own books;
- monitor the credit quality of the underlying assets on behalf of investors;
- report on the performance of the SE to investors; and
- make payments to investors on behalf of the SE.

Types of risks

As noted above, as an originator, sponsor or investor in a securitisation transaction, the Group may incur both credit and market risk. BIPRU prescribes how the Group calculates the regulatory capital it holds in connection with those risks. In addition, the Group may incur other types of risk.

Credit risk - The risk of loss arising from the failure of a customer or counterparty (or, in the case of a securitisation, an SE) to meet its obligations to settle outstanding amounts. Securitisation may expose the Group to credit risk for any of several reasons.

If the Group invests in an SE by purchasing (or, in the case of a securitisation it has originated, retaining) the bonds it issues, conducting derivative transactions with it or lending to it, the Group is exposed to the risk that the SE may fail to meet its obligations to settle outstanding amounts to it. This may happen because cash flows generated by the underlying assets are insufficient to repay creditors, including bondholders, derivative counterparties or lenders. In such a case, the SE pays principal and interest to creditors in order of seniority, with the most senior paid first.

When the Group originates a securitisation transaction, if the securitisation structure does not transfer the associated risks, including credit risk, to a third party, the Group is exposed to credit risk just as it would be if the securitisation had never taken place. Credit risk is heightened if the assets in the SE are not diversified by sector, geography or borrower.

The Group may seek to mitigate credit risk arising from the purchase (or retention) of bonds issued by an SE through the use of unfunded protection, usually credit default swaps, but also guarantees. The Group hedges the credit risk associated with purchased bonds, which are generally held in the trading book, as appropriate. The Group does not usually hedge the credit risk associated with retained bonds, which are generally held in the non-trading book.

In Non-Core, the Group holds legacy securitisation assets guaranteed by monoline insurance companies suffering financial distress, which reduces the value to the Group of their guarantees. For more information on unfunded protection and disclosure of monoline exposures, refer to page 299 of the Group's 2013 Annual Report and Accounts.

Market risk - The risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates and other factors, such as market volatilities, that may lead to a reduction in earnings, economic value or both. Securitisation may expose the Group to market risk for two major reasons.

First, if the Group invests in a securitisation, it is indirectly exposed to the risk of loss due to fluctuations in interest rates, foreign currency rates and other prices. For example, if the Group purchases notes issued by an SE paying interest at a rate other than the rate paid by the assets the SE holds, the two rates may respond differently to changes in market interest rates which may adversely affect the SE's ability to meet its obligations and cause the Group to suffer a loss. Similarly, if market interest rates rise, the value of fixed notes issued by an SE will fall, which may cause the Group to suffer a loss.

If the Group purchases notes issued by an SE in a currency other than the currency of the underlying assets, giving rise to the possibility that the cash flows generated by the assets may not be sufficient to repay investors, the Group may also suffer a loss.

Second, if the structure of a securitisation transaction does not transfer the associated market risk to a third party, the Group remains exposed to it as if the securitisation had never taken place.

Liquidity and funding risk - The risk that the Group may be unable to meet its financial obligations when they fall due. For further information, refer to pages 209 to 226 of the Group's 2013 Report and Accounts. The Group originates securitisations to diversify its sources of funding. The Group also sponsors securitisations, and as sponsor, it may provide liquidity facilities to the SE. If the SE utilises these facilities, the Group will need to fund them, giving rise to the risk that it may not be able to do so.

Legal risk - The risk that the Group may incur losses as a result of the failure of the documentation to perform as expected. Legal risk is elevated if the parties to the transaction are located in different jurisdictions, as the documentation effective in one jurisdiction may not be effective in another. Additional losses may arise as a result of costs incurred by the parties in an effort to address documentary shortcomings.

Securitisation

Types of risk *continued*

Regulatory risk - The risk of material loss or liability, legal or regulatory sanctions, or reputational damage, arising from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations or major industry standards in any location in which the Group operates.

Reputational risk - The risk of brand damage and/or financial loss arising from a failure to meet stakeholders' expectations of the Group's conduct and performance. If in its capacity as originator, sponsor or investor, the Group fails to meet the expectations of stakeholders, it may be unable to build or sustain relationships with customers, incur regulatory censure or experience reduced access to funding sources.

Operational risk - The risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. For more information, refer to pages 358 to 360 of the Group's 2013 Annual Report and Accounts.

Monitoring risks

The Group actively monitors and manages the risks inherent in its securitisation activities. With respect to the non-trading book, Non-Core manages the legacy positions mentioned above, including some re-securitisations. Group Treasury manages other securitisations, particularly those used by the Group as a means of diversifying its funding sources. Markets conducts transactions with SEs and manages trading book securitisation positions, including some re-securitisations.

Credit risk

The Group's overall exposure to securitisation is governed by its sector concentration framework. If the Group retains or purchases bonds issued by an SE, conducts derivative transactions with it or lends to it, the Group monitors the performance of the vehicle in part by reviewing information provided by the trustee as well as by rating agencies or other third parties. Assisted by third party advisors, a specialist team monitors re-securitisations. If the securitisation structure does not transfer credit risk to a third party, the Group manages it as if the securitisation had never taken place. Re-securitisation exposures are subject to individual scrutiny. For further information, refer to page 188 of the Group's 2013 Annual Report and Accounts.

Market risk

The Group manages this risk in accordance with its policy on market risk. Re-securitisation exposures are subject to individual scrutiny. For further information, refer to page 188 of the Group's 2013 Annual Report and Accounts.

Liquidity and funding risk

The Group manages these risks in accordance with Group policy on liquidity and funding risk. For further information, refer to page 187 of the Group's 2013 Annual Report and Accounts.

Legal risk

To manage legal risk, the Group follows a protocol designed to ensure that it meets its obligations as originator before and after the transaction is completed. Additionally, it monitors changes in relevant legislation in various jurisdictions as required thereafter.

Regulatory risk

Well established policies and supporting processes are in place to ensure timely identification of, and effective responses to, changes in official sector requirements impacting the Group. For more information, refer to page 190 of the Group's 2013 Annual Report and Accounts.

Reputational risk

The Group manages reputational risk in accordance with its reputational risk management framework. For more information, refer to page 191 of the Group's 2013 Annual Report and Accounts.

Regulatory treatment of securitisation

The Group determines the regulatory capital required for exposures related to its securitisation activities in accordance with BIPRU. In so doing, with respect to each securitisation transaction, it considers:

- the effectiveness of the securitisation structure in achieving risk transfer; and
- whether the securitisation positions it holds relate to the trading or non-trading book.

Refer to Chart 3 on the following page for an illustration of the regulatory treatment of securitisation.

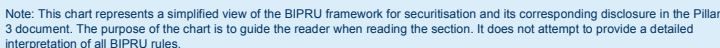
In instances where it is an originator, in accordance with BIPRU, the Group carries out a significant risk transfer assessment to evaluate, whether the securitisation structure effectively transfers the risks associated with the underlying assets to the holders of the securitisation positions.

If significant risk transfer takes place, the Group need not hold any capital against the underlying assets. However, to the extent that it does not, the Group must hold capital against the underlying assets as if the securitisation had never taken place. In other words, the Group does so in accordance with BIPRU rules governing the calculation of capital held in connection with credit risk, whether non-counterparty or counterparty, and market risk.

As noted earlier, the Group may play any of several roles in respect of securitisations. Of these, three may result in the Group holding securitisation positions in connection with which a capital charge is required: originator; sponsor; or investor.

In the case of securitisation positions related to the trading book, the Group calculates regulatory capital needed for specific and general market risks (refer to page 332 of the Group's 2013 Annual Report and Accounts). In the case of exposures related to the non-trading book, the Group calculates regulatory capital needed for credit risk, either non-counterparty or counterparty.

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The regulatory framework for securitisation allows RWA calculation using either the STD or the IRB approach. The choice of approach depends on the credit framework adopted by the firm under Pillar 1 for the underlying portfolio of securitised exposures. The Group holds securitisation positions subject to both approaches, as shown in Table 43.

Under both approaches, the Group uses the ratings based approach (RBA) to assess rated positions. The Group recognises ratings issued by Standard & Poor, Moody's, Fitch or DBRS when assessing debt issued by SEs under the RBA. For most transactions, the Group uses the services of two or more of these rating agencies, which are formally classified as external credit assessment institutions.

Summary of accounting policies including derecognition

Assets with risk-weights > 1250% are shown as capital deductions

Securitisation

Summary of accounting policies including derecognition *continued*

Recognition of sales

A securitisation is first assessed by the Group to determine whether it needs to consolidate any of the vehicles used. An assessment is made under International Financial Reporting Standard 'Consolidated Financial Statements' (IFRS 10). IFRS 10 requires the consolidation of entities that are controlled by the Group. Control exists when the Group has power to direct the activities of the entity so as to vary returns for the Group. Whether a securitisation is treated as a sale or financing depends on whether the derecognition tests of International Accounting Standard 'Financial Instruments: Recognition and Measurement' (IAS 39) are met. The Group's accounting policy on derecognition is detailed below.

A financial asset is derecognised when the contractual right to receive cash flows from the asset has expired or when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows, but assumes a contractual obligation to pay these cash flows to a third party. Following a transfer, the Group assesses the extent to which it retains the risks and rewards of ownership of the transferred asset. The asset remains on the balance sheet if all of the risks and rewards are retained. The asset is derecognised if all of the risks and rewards are transferred. If the majority of the risks and rewards are neither retained nor transferred, the Group assesses whether or not it retains control of the asset. If it does not retain control, the asset is derecognised. Where the Group retains control, it continues to recognise its involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, is cancelled or expires. On 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 depending on 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 with different terms. An assessment of any difference in terms considers qualitative and quantitative characteristics, including a comparison of the present value of cash flows under the new terms with the present value of the remaining cash flows of the original debt issue, discounted at its effective interest rate.

Key assumptions for valuing securitisation positions

Securitisation positions are valued using external information, such as market data for recent transactions, price information from third-party managers and advisors, and asset performance data provided to all bond holders at interest payment dates.

Synthetic securitisations

Synthetic securitisations are assessed using the same approach as non-synthetic securitisations. Any derivatives are treated in accordance with IAS 39 requirements.

Assets awaiting securitisation

Assets are valued using normal methods appropriate to the asset class, until a securitisation meets the criteria to be derecognised under IFRS. At both 31 December 2013 and 31 December 2012, the Group had no assets categorised as awaiting securitisation.

The Group recognises all contractual commitments, such as liquidity lines, and applies the accounting policies set out in the Group's 2013 Annual Report and Accounts.

Securitisation and re-securitisation exposures

Additional information detailing the Group's accounting policies, and treatment of securitisations and re-securitisations, can be found on pages 467 and 468 of the Group's 2013 Annual Report and Accounts.

Types of transactions

In the role of originator, the Group securitises a variety of assets which typically include the following:

Residential mortgages and commercial real estate loans - The Group securitises residential mortgages and commercial real estate loans that it originates itself. Mortgages and real estate loans are assigned to SEs, which fund themselves principally through the issue of floating rate notes.

Credit card receivables - In the UK, the Group securitises credit card receivables that it originates itself. Noteholders have a proportionate interest in a pool of credit card receivables that are assigned by the Group to a receivables trust.

Other loan types - The Group selectively securitises other loans that it originates, principally those to corporates and small and medium-sized enterprises.

SEs used by the Group

Securitisation SEs used by the Group hold either the securitised assets themselves (traditional securitisations) or the rights to those assets (synthetic securitisations).

At 31 December 2013, the Group's four multi-seller commercial paper conduit programmes for which the Group provides programme-wide credit enhancement and liquidity facilities had no externally issued commercial paper. The conduit programmes available for use were Thames Asset Global Securitization, George Street Finance, Abel Tasman and Orchid Funding Corporation. Details can be found in the conduit disclosure on page 467 of the Group's 2013 Annual Report and Accounts.

The Group also had a single own-asset conduit, Churchill, in place at 31 December 2013. All of the commercial paper issued by the conduit was retained by the Group.

The transactions in which the Group acts as a swap counterparty, has originated all the assets and continues to administer the associated SEs include the following:

- Arran (cards master trust);
- Arran (UK residential mortgages SEs);
- Artesian (UK water companies SEs);
- Celtic (Irish residential mortgages SEs);
- EPIC (commercial real estate SEs);
- Greenock (UK residential mortgages SEs); and
- Talisman (commercial real estate SEs).

All of the securities issued by Greenock were retained by the Group.

SEs with the same brand name share similarities such as the asset type securitised and the Group's role in the transaction.

Securitisation

Notes on the following tables

Tables 43 to 46 show the Group's total securitisation positions, as discussed under 'Regulatory treatment of securitisation' on page 68. The exposures included those retained from the Group's own securitised assets, investments in SE notes, credit lines to SEs and derivative transactions with SEs.

Tables 47 to 49 show outstanding amounts of securitised positions, as reported on the investment reports of the SEs in which these positions are held.

The term 'exposure amount' used in the following tables refers to EAD, which is calculated according to BIPRU rules.

Exposure amount is shown along with other measures in Tables 43, 44 and 50. Tables 45 and 46 show exposure amounts exclusively.

Table 43: Securitisation positions, retained or purchased, RWAs and minimum capital requirements

The following table shows the Group's exposures, RWAs, minimum capital requirements and capital deductions calculated under the STD and IRB approaches.

	Aggregate amounts of securitisation positions retained or purchased				Of which, re-securitisation positions retained or purchased			
	Exposure amount £m	RWAs £m	Minimum capital requirements £m	Of which deduction from capital £m	Exposure amount £m	RWAs £m	Minimum capital requirements £m	Of which deduction from capital £m
2013 - non-trading book								
IRB approach (1)	20,968	4,181	683	348	254	158	12	24
Standardised approach	1,389	401	248	216	48	19	2	—
	22,357	4,582	931	564	302	177	14	24
2012 - non-trading book								
IRB approach (1)	33,081	7,357	1,174	585	838	244	151	133
Standardised approach	522	262	280	259	—	—	—	—
	33,603	7,619	1,454	844	838	244	151	133
2013 - trading book								
IRB approach	1,453	1,099	582	495	396	365	206	178
Standardised approach	1,247	442	473	437	249	92	102	95
	2,700	1,541	1,055	932	645	457	308	273
2012 - trading book								
IRB approach	1,755	1,288	853	751	557	288	230	207
Standardised approach	1,740	675	673	619	364	225	138	120
	3,495	1,963	1,526	1,370	921	513	368	327

Note:

(1) Includes EAD of £2.1 billion (2012 - £3.9 billion) and RWAs of £0.8 billion (2012 - £1.4 billion) related to counterparty credit risk associated with derivative trades. The relevant market risk is captured in the trading book.

Key points

- Total exposure amounts for retained or purchased securitisation and re-securitisation positions in both the non-trading and trading books continued to decline in 2013, in line with the Group's risk reduction strategy.
- In the non-trading book, the decrease in total exposure was largely driven by disposals in Non-Core's available-for-sale portfolio, further maturities, early repayment of liquidity facilities, the run-off of the conduit business and the disposal of trust funds. This overall decrease was somewhat offset by the increase in exposure under the standardised approach, which was due to the purchase of non-agency residential mortgage-backed securities (RMBS) by US Retail & Commercial.
- In the trading book, the decrease in exposure was driven by business strategy aimed at reducing low rated asset-backed exposures.
- RWAs associated with securitisation positions under the IRB approach also declined, in line with the reduction in exposure.

Securitisation

Table 44: Securitisation positions, retained or purchased, by risk-weightings

The following table shows exposures and minimum capital requirements according to risk-weight bands.

Risk-weight bands	Aggregate amounts of securitisation positions retained or purchased						Of which, re-securitisation positions retained or purchased					
	Exposure amount			Minimum capital requirements			Exposure amount			Minimum capital requirements		
	STD £m	IRB £m	Total £m	STD £m	IRB £m	Total £m	STD £m	IRB £m	Total £m	STD £m	IRB £m	Total £m
2013 - non-trading book (1)												
≤ 10%	—	13,615	13,615	—	85	85	—	—	—	—	—	—
> 10% ≤ 20%	861	4,198	5,059	13	53	66	—	38	38	—	1	1
> 20% ≤ 50%	271	1,742	2,013	9	55	64	48	110	158	2	2	4
> 50% ≤ 100%	9	832	841	1	59	60	—	67	67	—	3	3
> 100% ≤ 350%	32	12	44	9	2	11	—	—	—	—	—	—
> 350% ≤ 650%	—	221	221	—	81	81	—	15	15	—	6	6
1,250%/deduction	216	348	564	216	348	564	—	24	24	—	—	—
	1,389	20,968	22,357	248	683	931	48	254	302	2	12	14
2012 - non-trading book (1)												
≤ 10%	—	21,508	21,508	—	139	139	—	—	—	—	—	—
> 10% ≤ 20%	180	5,802	5,982	3	74	77	—	134	134	—	2	2
> 20% ≤ 50%	24	3,207	3,231	5	86	91	—	548	548	—	11	11
> 50% ≤ 100%	26	1,398	1,424	2	97	99	—	6	6	—	—	—
> 100% ≤ 350%	33	204	237	11	44	55	—	1	1	—	—	—
> 350% ≤ 650%	—	377	377	—	149	149	—	16	16	—	5	5
1,250%/deduction	259	585	844	259	585	844	—	133	133	—	133	133
	522	33,081	33,603	280	1,174	1,454	—	838	838	—	151	151
2013 - trading book												
≤ 10%	—	169	169	—	4	4	—	5	5	—	—	—
> 10% ≤ 20%	379	235	614	6	4	10	—	53	53	—	1	1
> 20% ≤ 50%	274	80	354	10	3	13	119	5	124	4	—	4
> 50% ≤ 100%	120	305	425	10	25	35	27	79	106	2	6	8
> 100% ≤ 350%	37	52	89	10	10	20	8	35	43	1	6	7
> 350% ≤ 650%	—	115	115	—	40	40	—	39	39	—	14	14
> 650% ≤ 1,250%	—	2	2	—	1	1	—	2	2	—	1	1
1,250%/deduction	437	495	932	437	495	932	95	178	273	95	178	273
	1,247	1,453	2,700	473	582	1,055	249	396	645	102	206	308
2012 - trading book												
≤ 10%	—	175	175	—	1	1	—	62	62	—	—	—
> 10% ≤ 20%	553	185	738	9	3	12	—	80	80	—	1	1
> 20% ≤ 50%	282	153	435	10	4	14	147	65	212	5	1	6
> 50% ≤ 100%	215	294	509	17	21	38	63	95	158	5	8	13
> 100% ≤ 350%	66	53	119	15	9	24	30	35	65	5	5	10
> 350% ≤ 650%	5	142	147	3	63	66	5	11	16	3	6	9
> 650% ≤ 1,250%	—	2	2	—	2	2	—	2	2	—	2	2
1,250%/deduction	619	751	1,370	619	750	1,369	119	207	326	120	207	327
	1,740	1,755	3,495	673	853	1,526	364	557	921	138	230	368

Note:

(1) Non-trading book IRB exposure includes EAD of £2.1 billion (2012 - £3.9 billion) and RWAs of £0.8 billion (2012 - £1.4 billion) related to counterparty credit risk associated with derivative trades. The relevant market risk is captured in the trading book.

Key points

- In the non-trading book, the decline in securitisation exposure under the IRB approach, in line with the Group's risk reduction strategy, was evident in all risk-weight bands. The reduction largely occurred in the two lowest bands, which accounted for the bulk of the exposure.
- The offsetting increase in non-trading standardised exposure, reflecting US Retail & Commercial's purchases of non-agency RMBS, occurred in the second and third lowest risk-weight bands.
- In the trading book, total exposure fell in all risk-weight bands, driven by business strategy.

Securitisation

Table 45: Securitisation positions, retained or purchased, by risk-weightings and underlying exposure type

The following table shows exposures by underlying exposure type and risk-weight bands.

Risk-weight bands	Residential mortgages £m	Commercial mortgages £m	Credit card receivables £m	Leasing £m	Loans to corporates or SMEs £m	Customer loans £m	Trade receivables £m	Auto receivables £m	Re-securitisation £m	Other assets £m	Total £m
2013 - non-trading book (1)											
≤ 10%	7,773	220	786	181	21	253	178	2,648	—	1,555	13,615
> 10% ≤ 20%	2,413	474	242	224	283	—	—	365	38	1,020	5,059
> 20% ≤ 50%	274	891	—	—	148	—	—	—	158	542	2,013
> 50% ≤ 100%	105	117	—	—	—	9	—	—	67	543	841
> 100% ≤ 350%	32	—	—	—	—	—	—	—	—	12	44
> 350% ≤ 650%	14	190	—	—	—	—	—	—	15	2	221
1,250%/deduction	310	100	—	19	—	—	—	—	24	111	564
	10,921	1,992	1,028	424	452	262	178	3,013	302	3,785	22,357
2012 - non-trading book (1)											
≤ 10%	10,883	207	916	319	66	722	954	3,994	—	3,447	21,508
> 10% ≤ 20%	3,276	429	98	20	176	—	22	275	134	1,552	5,982
> 20% ≤ 50%	121	1,172	—	—	148	—	—	30	548	1,212	3,231
> 50% ≤ 100%	154	205	—	—	77	—	—	—	6	982	1,424
> 100% ≤ 350%	90	2	—	—	—	—	—	—	1	144	237
> 350% ≤ 650%	69	207	—	—	—	—	—	—	16	85	377
1,250%/deduction	357	46	—	53	—	—	—	—	133	255	844
	14,950	2,268	1,014	392	467	722	976	4,299	838	7,677	33,603
2013 - trading book											
≤ 10%	48	—	—	—	—	—	—	—	5	116	169
> 10% ≤ 20%	108	62	7	—	—	—	—	53	53	331	614
> 20% ≤ 50%	27	25	1	—	—	—	—	4	124	173	354
> 50% ≤ 100%	38	50	—	—	—	—	—	3	106	228	425
> 100% ≤ 350%	2	20	—	—	—	—	—	—	43	24	89
> 350% ≤ 650%	18	27	—	—	—	—	—	—	39	31	115
> 650% ≤ 1,250%	—	—	—	—	—	—	—	—	2	—	2
1,250%/deduction	236	148	—	—	—	—	—	—	273	275	932
	477	332	8	—	—	—	—	60	645	1,178	2,700
2012 - trading book											
≤ 10%	78	17	2	—	—	—	—	—	62	16	175
> 10% ≤ 20%	68	238	38	—	—	—	—	60	80	254	738
> 20% ≤ 50%	14	64	1	—	—	—	—	8	212	136	435
> 50% ≤ 100%	14	133	—	—	—	—	—	1	158	203	509
> 100% ≤ 350%	27	21	—	—	—	—	—	—	65	6	119
> 350% ≤ 650%	33	49	—	—	—	—	—	—	16	49	147
> 650% ≤ 1,250%	—	—	—	—	—	—	—	—	2	—	2
1,250%/deduction	406	303	—	—	—	—	—	—	326	335	1,370
	640	825	41	—	—	—	—	69	921	999	3,495

Note:

(1) Includes counterparty credit risk EAD of £2.1 billion (2012 - £3.9 billion), which is primarily related to residential mortgages of £1.2 billion (2012 - £1.8 billion) and other assets of £0.9 billion (2012 - £2.0 billion).

Key points

- In the non-trading book, the three largest exposure types experienced a decline over the period. For residential mortgages, this was largely driven by the run-off of the conduit business, partially offset by the increase in exposure in US Retail & Commercial. For auto receivables, it was driven by the maturing of liquidity facilities. For the other assets category, of which the largest sub-category is collateralised debt obligations, the decline was due to disposals in the available-for-sale portfolio and Non-Core run-off.
- In the trading book, exposure declined for almost all exposure types in the majority of risk-weight bands. The decrease was typically more marked in the 1,250% band than in other bands, reflecting sales of low quality exposures.

Securitisation

Table 46: Securitisation positions, retained or purchased, on and off-balance sheet

The following table shows underlying exposures by:

- the role of the Group;
- on and off-balance sheet categories; and
- underlying exposure type.

The off-balance sheet category represents the part of a liquidity facility that has not been utilised.

Underlying exposure type	As originator		As sponsor		As investor		Total	
	On-balance sheet £m	Off-balance sheet £m	On-balance sheet £m	Off-balance sheet £m	On-balance sheet £m	Off-balance sheet £m	On-balance sheet £m	Off-balance sheet £m
2013 - non-trading book (1)								
Residential mortgages	—	—	895	346	8,265	1,415	9,160	1,761
Commercial mortgages	85	—	—	—	1,517	390	1,602	390
Credit card receivables	—	—	184	8	436	400	620	408
Leasing	—	—	—	—	343	81	343	81
Loans to corporates or SMEs	—	—	—	—	189	263	189	263
Consumer loans	—	—	35	16	89	122	124	138
Trade receivables	—	—	158	20	—	—	158	20
Auto receivables	—	—	20	—	2,165	828	2,185	828
Re-securitisations	8	—	—	—	270	24	278	24
Other assets	5	—	130	16	2,544	1,091	2,679	1,107
	98	—	1,422	406	15,818	4,614	17,338	5,020
2012 - non-trading book (1)								
Residential mortgages	—	—	888	795	11,142	2,125	12,030	2,920
Commercial mortgages	—	11	—	—	2,022	235	2,022	246
Credit card receivables	—	—	77	—	473	464	550	464
Leasing	—	—	148	5	239	—	387	5
Loans to corporates or SMEs	—	—	77	—	360	30	437	30
Consumer loans	—	—	447	61	106	108	553	169
Trade receivables	—	—	191	34	388	363	579	397
Auto receivables	—	—	450	352	1,891	1,606	2,341	1,958
Re-securitisations	98	—	—	—	671	69	769	69
Other assets	—	5	146	21	4,309	3,190	4,455	3,216
	98	16	2,424	1,268	21,601	8,190	24,123	9,474
2013 - trading book								
Residential mortgages	8	—	—	—	433	36	441	36
Commercial mortgages	14	2	—	—	233	83	247	85
Credit card receivables	—	—	—	—	8	—	8	—
Auto receivables	—	—	—	—	60	—	60	—
Re-securitisations	155	—	—	—	350	140	505	140
Other assets	41	—	—	—	1,009	128	1,050	128
	218	2	—	—	2,093	387	2,311	389
2012 - trading book								
Residential mortgages	9	—	—	—	517	114	526	114
Commercial mortgages	94	4	—	—	596	131	690	135
Credit card receivables	—	—	—	—	41	—	41	—
Auto receivables	—	—	—	—	69	—	69	—
Re-securitisations	153	2	—	—	504	262	657	264
Other assets	13	1	—	—	956	35	969	36
	269	7	—	—	2,683	542	2,952	549

Note:

(1) Includes counterparty credit risk EAD of £2.1 billion (2012 - £3.9 billion), which is primarily related to residential mortgages of £1.2 billion (2012 - £1.8 billion) and other assets of £0.9 billion (2012 - £2.0 billion).

Key points

- The overall reduction in the Group's non-trading book securitisation positions was evident in both the on and off-balance sheet categories.
- Where the Group acted as investor, this reduction was largely driven by Non-Core run-off.
- Where the Group acted as sponsor, this reduction was largely driven by disposals in the available-for-sale portfolio and the maturity and early repayment of liquidity facilities extended by the Group to conduits.

Securitisation

Table 47: Securitised exposure amounts

The following table shows the Group's securitised exposures (for which it retains no risk) by:

- the role of the Group;
- exposure type; and
- the nature of the securitisations.

Exposure type	Outstanding amounts of exposures securitised			
	As originator		Sponsor - traditional £m	Total £m
	Traditional £m	Synthetic £m		
2013 - non-trading book				
Residential mortgages	—	—	968	968
Commercial mortgages	6,783	494	477	7,754
Credit card receivables	—	—	41	41
Loans to corporates or SMEs	2,600	—	131	2,731
Consumer loans	—	—	363	363
Trade receivables	—	—	365	365
Auto receivables	—	—	324	324
Other assets	—	—	184	184
	9,383	494	2,853	12,730
2012 - non-trading book				
Residential mortgages	—	—	1,641	1,641
Commercial mortgages	2,684	191	499	3,374
Credit card receivables	—	—	41	41
Loans to corporates or SMEs	2,945	—	134	3,079
Consumer loans	—	—	814	814
Trade receivables	—	—	561	561
Auto receivables	—	—	803	803
Other assets	—	—	228	228
	5,629	191	4,721	10,541
2013 - trading book				
Re-securitisations	2,034	—	—	2,034
2012 - trading book				
Re-securitisations	1,987	—	—	1,987

Key points

- Securitised exposures increased in both the non-trading and trading books, notably exposure to commercial mortgage deals.
- The increase in commercial mortgage exposure largely reflected not only new securitisation activity during the year (refer to the following table), but also the inclusion of three historical transactions (two traditional and one synthetic) that achieved significant risk transfer during 2013.
- The overall increase was partially offset by the run-off of the conduit business, which led to decreases in non-trading book exposures arising from transactions where the Group acted as sponsor.

Securitisation

Table 48: Exposures securitised during the year

The following table shows the Group's securitisation of its own assets during the year.

Exposure type	Outstanding amounts of exposures securitised						Total new securitised exposures £m
	As originator			As sponsor			
	Traditional £m	Recognised gain or loss on sale £m	Synthetic £m	Recognised gain or loss on sale £m	Traditional £m	Recognised gain or loss on sale £m	
2013 - non-trading book							
Commercial mortgages	2,953	68	—	—	—	—	3,021
2012 - non-trading book							
Residential mortgages	—	—	—	—	227	—	227
Commercial mortgages	1,410	56	—	—	—	—	1,466
Auto receivables	—	—	—	—	392	—	392
	1,410	56	—	—	619	—	2,085
2013 - trading book							
Re-securitisations	996	—	—	—	—	—	996
2012 - trading book							
Re-securitisations	1,684	—	—	—	—	—	1,684

Refer to the commentary after Table 47.

Table 49: Impaired and past due securitised exposure and losses

The following table shows impaired or past due amounts of assets of which the Group is the originator. Losses on these exposures recognised by the Group during 2013 were nil.

	Outstanding amounts of exposures securitised as originator	
	Impaired/past due £m	Losses £m
2013 - non-trading book		
Loans to corporates or SMEs	123	—
2012 - non-trading book		
Loans to corporates or SMEs	120	—

Securitisation

Table 50: Total trading book minimum capital requirements amounts (excluding capital deductions) for outstanding securitisation positions subject to market risk capital requirements

The following table shows trading book exposures subject to securitisation specific market risk capital regulations.

These regulations apply to securitisation positions in the trading book with the exception of those in the 1,250% risk-weight band.

The Group had no synthetic exposures subject to the capital regulations at either 31 December 2013 or 31 December 2012.

Underlying portfolio	Exposure amount	Minimum capital requirement (excluding reductions)
	Traditional £m	Traditional £m
2013 - trading book		
Residential mortgages	241	12
Commercial mortgages	184	25
Credit card receivables	8	—
Auto receivables	60	1
Re-securitisations	372	36
Other assets	903	49
	1,768	123
2012 - trading book		
Residential mortgages	234	24
Commercial mortgages	522	43
Credit card receivables	41	1
Auto receivables	69	1
Re-securitisations	594	41
Other assets	665	46
	2,125	156

Key point

- The overall amount of securitisation positions in the trading book subject to market risk capital requirements and, thus, the associated minimum capital requirements decreased in 2013. This was mainly driven by decreases in positions in commercial mortgages and re-securitisations, offset somewhat by an increase in other assets.

Glossary

Acronyms

ABCP	Asset-backed commercial paper	IPRE	Income-producing real estate
AFS	Available-for-sale	IRB	Internal ratings based
AIRB	Advanced internal ratings based	LGD	Loss given default
AQ	Asset quality	LIBOR	London Interbank Offered Rate
BBSW	Bank Bill Swap Reference Rate (Australia)	mtm	mark-to-market
BIPRU	Prudential sourcebook for Banks, Building Societies and Investment Firms	NTIRR	Non-traded interest rate risk
CCF	Credit conversion factor	OTC	Over-the-counter
CDOR	Canadian Dollar Offered Rate	PD	Probability of default
CEM	Counterparty exposure management	PFE	Potential future exposure
CQS	Credit quality steps	PIT	Point-in-time
CRD	Capital Requirements Directive	PRA	Prudential Regulation Authority
CRM	Credit risk mitigation	RAR	Risk asset ratio
CVA	Credit valuation adjustment	RBA	Ratings based approach
DNB	De Nederlandsche Bank	RCR	RBS Capital Resolution
EAD	Exposure at default	RMBS	Residential mortgage-backed securities
EL	Expected loss	RoW	Rest of the World
EPE	Expected positive exposure	RWAs	Risk-weighted assets
EU	European Union	S&P	Standard and Poor's
EURIBOR	Euro Interbank Offered Rate	SE	Structured entity
IAA	Internal assessment approach	SMEs	Small and medium-sized enterprises
IAS	International Accounting Standard	STD	Standardised
ICAAP	Internal capital adequacy assessment process	The Group	The Royal Bank of Scotland Group plc and its subsidiaries
IFRS	International Financial Reporting Standard	TTC	Through-the-cycle
IMM	Internal model method	VaR	Value-at-risk

Glossary

Key terms

Alpha - in the context of regulatory capital for counterparty risk, under the internal model method, alpha is a multiplier applied to the effective expected positive exposure (EPE) to determine the exposure at default. Alpha may be set using an own estimate with a floor of 1.2. It accounts for the extra capital needed for derivatives, compared to loans with the same EPE, to reflect the additional risks.

Arm's length - parties in a transaction or a business relationship are at arm's length when they are independent and on an equal footing. They should be acting in their own self interest and not subject to any pressure or duress from any of the other parties.

Arrears - the aggregate of contractual payments due on a debt that have not been met by the borrower. A loan or other financial asset is said to be 'in arrears' when payments have not been made.

Asset-backed commercial paper (ABCP) - a form of asset-backed security generally issued by a commercial paper conduit.

Asset quality (AQ) band - probability of default banding for all counterparties on a scale of 1 to 10.

Basel II - the capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.

Basel III - in December 2010, the Basel Committee on Banking Supervision issued final rules: 'Basel III: A global regulatory framework for more resilient banks and banking systems' and 'Basel III: International framework for liquidity risk measurement, standards and monitoring'.

BIPRU (Prudential sourcebook for Banks, Building Societies and Investment Firms) - the part of the Prudential Regulatory Authority's Handbook that sets out detailed prudential requirements for the banks that it regulates.

Commercial paper conduit - a structured entity that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed either by further commercial paper issuance, repayment of assets or liquidity drawings.

Common Equity Tier 1 capital - the highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.

Core Tier 1 capital - called-up share capital and eligible reserves plus equity non-controlling interests, less intangible assets and other regulatory deductions.

Counterparty credit risk - the risk that a counterparty defaults before the maturity of a derivative or sale and repurchase contract. In contrast to non-counterparty credit risk, the exposure to counterparty credit risk varies by reference to a market factor (e.g. interest rate, exchange rate, asset price).

CRD IV - the European Union has implemented the Basel III capital proposals through the Capital Requirements Regulation and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The European Banking Authority's technical standards are still to be finalised through adoption by the European Commission and implemented within the UK.

Credit conversion factor (CCF) - the CCF is an estimate of the proportion of undrawn commitments that will be drawn at the point of default. It is used in determining EAD and reflects the assumption that drawn balance at default might be greater than the current balance.

Credit default swap - a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event in relation to a reference financial asset or portfolio of financial assets. Credit events usually include bankruptcy, payment default and rating downgrades.

Credit grade - a rating that represents an assessment of the creditworthiness of a customer. It is a point on a scale representing the probability of default of a customer.

Credit quality step (CQS) - a grade on the PRA credit quality assessment scale based on the credit ratings of external credit assessment institutions. It is used to assign risk weights under the standardised approach to credit risk.

Credit risk - the risk of financial loss due to the failure of a customer, or counterparty, to meet its obligation to settle outstanding amounts.

Credit risk mitigation (CRM) - reducing the credit risk of an exposure by application of techniques such as netting, collateral, guarantees and credit derivatives.

Credit spread - the credit spread is the yield spread between securities with the same currency and maturity structure but with different associated credit risks, with the yield spread rising as the credit rating worsens. It is the premium over the benchmark or risk-free rate required by the market to take on a lower credit quality.

Credit valuation adjustment (CVA) - the CVA is the difference between the risk-free value of a portfolio of trades and its market value, taking into account the counterparty's risk of default. It represents the market value of counterparty credit risk, or an estimate of the adjustment to fair value that a market participant would make to reflect the creditworthiness of its counterparty.

Glossary

Key terms continued

Effective expected positive exposure (effective EPE) - effective EPE is a measure used to determine EAD for OTC derivatives under the internal model method. It is calculated as the weighted average of non-decreasing expected positive exposures. The weight of each exposure is calculated as a percentage of total expected exposure over the relevant period. When calculating the minimum capital requirement, the average is taken over the first year.

Expected loss - expected loss represents the anticipated loss on an exposure over one year. It is determined by multiplying probability of default, loss given default and exposure at default and can be calculated at individual, credit facility, customer or portfolio level.

Exposure - a claim, contingent claim or position which carries a risk of financial loss.

Exposure at default (EAD) - an estimate of the extent to which the bank will be exposed under a specific facility, in the event of the default of a counterparty.

Exposure class - exposures are assigned to classes defined under BIPRU regulations, namely regulation 4.3.2 for the advanced IRB approach and regulation 3.2.9 for the standardised approach. This classification is required by the regulatory framework when calculating the capital requirements of banks.

Fair value - the amount for which an asset could be exchanged or a liability settled, between knowledgeable and willing parties in an arm's length transaction.

Guarantees - an agreement by a third party to cover the potential loss to the Group should a specified counterparty default on its commitments.

Haircut - a downward adjustment to collateral value to reflect its nature, any currency or maturity mismatches between a credit risk mitigant and the underlying exposure to which it is being applied.

Income-producing real estate - comprises real estate exposures that meet the following BIPRU (or regulatory) criteria for specialised lending exposures: (i) the exposure is to an entity that was created specifically to finance and/or operate physical assets; (ii) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and (iii) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise. It therefore constitutes a sub-set of the Group's overall exposure to commercial real estate.

Interest rate risk - the adverse impact on the value or interest income of a financial asset arising from changes in interest rates.

Internal Capital Adequacy Assessment Process (ICAAP) - the Group's own assessment, as part of Basel II requirements, of its risks, how it intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

Internal model method (IMM) - in the context of counterparty credit risk, the IMM is the most risk-sensitive and sophisticated approach to calculating EAD out of the three methods available under Basel II. Under the IMM firms may use their internal model which should be aligned to the firm's internal risk management practices. EAD is calculated as the product of alpha and EPE.

Internal ratings based approach (IRB) - a method of estimating the amount of credit risk taken by a bank. Under IRB a bank may use internal estimates to generate risk components for use in the calculation of its credit risk regulatory capital requirements. There are two approaches: foundation and advanced (including retail).

Latent loss provisions - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified as impaired at the balance sheet date.

Loss given default (LGD) - an estimate of the amount that will not be recovered by the Group in the event of default, plus the cost of debt collection activities and the delay in cash recovery.

Market risk - the risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both.

Mark-to-market (mtm) - the adjustment in the value of an asset or liability to reflect any change in market prices.

Mark-to-market method - in the context of counterparty credit risk, the mtm method is the simplest of three methods used to determine exposure values. The exposure value is calculated as the mtm value plus the potential future exposure (PFE) value, where the PFE is a percentage of the notional value of the contract. The percentage to be applied varies by product and maturity.

Minimum capital requirements - the minimum amount of regulatory capital that a financial institution must hold to meet the Pillar 1 requirements for credit, market and operational risk.

Monoline insurers (monolines) - entities that specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default. This protection is typically in the form of derivatives such as credit default swaps.

Netting - the process by which the value of assets taken from a given counterparty is offset by the value of assets given to the same counterparty, thereby reducing the exposure of one party to the other to the difference between the two.

Non-trading book - positions, exposures, assets and liabilities that are not in the trading book. It is also referred to as "banking book".

Glossary

Operational risk - the risk of loss resulting from inadequate or failed processes, people, systems or from external events.

Over-the-counter (OTC) derivatives - derivatives with tailored terms and conditions negotiated bilaterally, in contrast to exchange traded derivatives which have standardised terms and conditions.

Pillar 1 - the part of Basel II that sets out the process by which regulatory capital requirements should be calculated for credit, market and operational risk

Pillar 2 - the part of Basel II that sets out the process by which a bank should review its overall capital adequacy and the processes under which the supervisors evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments.

Pillar 3 - the part of Basel II that sets out the information banks must disclose about their risks, the amount of capital required to absorb them, and their approach to risk management. The aim is to strengthen market discipline.

Point-in-time (PIT) - an assessment of PD or a rating system based on a view of a counterparty's current rather than future financial situation given economic conditions. This differs from a through-the-cycle approach, which considers performance over the duration of an economic cycle.

Position risk requirement - a capital requirement applied to a position treated under BIPRU 7 (Market risk) as part of the calculation of the market risk capital requirement.

Probability of default (PD) - the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon.

Prudential Regulation Authority (PRA) - the statutory body responsible, from 1 April 2013, for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.

Repo - refer to sale and repurchase agreements.

Re-securitisations - securitisations in which the underlying pools of assets are themselves bonds issued by securitisation SEs.

Residential mortgage-backed securities (RMBS) - asset-backed securities for which the underlying asset portfolios are residential mortgages.

Residual maturity - the remaining time in years that a borrower is permitted to take to fully discharge its contractual obligation (principal, interest and fees) under the terms of a loan agreement.

Reverse repurchase agreement (reverse repo) - repurchase agreements are short-term funding arrangements that allow counterparties to use financial securities as collateral for interest-bearing cash loans. The borrower agrees to sell a security to the lender subject to a commitment to repurchase the same security at an agreed date and price; usually the original sale price plus an amount representing interest for the period. Refer to sale and repurchase agreements.

Risk-weighted assets (RWAs) - assets adjusted for their associated risks using weightings established in accordance with the Basel Capital Accord as implemented by the PRA. Certain assets are not weighted but deducted from capital.

Sale and repurchase agreements - in a sale and repurchase agreement one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell it at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and from the buyer's reverse repurchase agreements (reverse repos).

Securitisation - a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a structured entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income generating assets (ranging from credit card receivables to residential mortgage loans).

Securitisation position - refers to any exposures the Group may have to a securitisation. These include not only the securities issued by a securitisation SE, but also loans, liquidity facilities and derivatives transacted with a securitisation SE.

Securitized exposure - an asset, or a pool of assets, that has been securitised, either via a traditional securitisation or a synthetic securitisation. See traditional securitisation and synthetic securitisation below.

Standard industrial classification - a classification of businesses by type or economic activity. It is applied by international government agencies to provide a framework for the collection, tabulation, presentation and analysis of data related to industry sectors, and its use promotes uniformity.

Standardised (STD) approach - a method used to calculate credit risk capital requirements under Pillar 1 of Basel II. In this approach the risk-weights used in the capital calculation are determined by regulators. For operational risk, capital requirements are determined by multiplying three years' historical gross income by a percentage determined by the regulator. The percentage ranges from 12% to 18%, depending on the type of underlying business being considered.

Stress testing - a technique used to evaluate the potential effects on an institution's financial condition of an exceptional but plausible event and/or movement in a set of financial variables.

Glossary

Key terms *continued*

Stressed value-at-risk - a VaR measure using historical data from a one year period of stressed market conditions. For the purposes of calculating regulatory stressed VaR, a time horizon of ten trading days is assumed at a confidence level of 99% (Refer to VaR definition below).

Structured entity (SE) - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they 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.

Supervisory slotting approach - a method of calculating regulatory capital, specifically for lending exposures in project finance and income-producing real estate, where the PD estimates do not meet the minimum IRB standards. Under this approach, the bank classifies exposures from 1 to 5, where 1 is Strong and 5 is Default. Specific risk-weights are assigned to the classifications in line with BIPRU 4.5.

Synthetic securitisation - a securitisation process in which, the originating bank retains legal ownership of a pool of assets, but transfers the associated credit risk to an arm's length SE through the use of credit-linked notes or credit derivatives.

Tier 1 capital - Core Tier 1 capital plus other Tier 1 securities in issue, less material holdings in financial companies.

Tier 1 capital ratio - Tier 1 capital as a percentage of risk-weighted assets.

Tier 2 capital - qualifying subordinated debt and other Tier 2 securities in issue, eligible collective impairment allowances, unrealised available-for-sale equity gains and revaluation reserves less certain regulatory deductions.

Trading book - a trading book consists of positions in financial instruments and commodities held either with the intent to trade, or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability, or able to be hedged.

Traditional securitisation - securitisation in which the originating bank transfers legal ownership of a pool of assets to an arm's length SE.

Undrawn commitments - assets/liabilities that have been committed but not yet transacted. In terms of credit risk, these are obligations to make loans or other payments in the future.

Value-at-risk (VaR) - for the purpose of market risk, VaR is a technique that produces estimates of the potential loss in the market value of a portfolio over a specified time period at a given confidence level.