

**Company Registered No: 00036695**

**COUTTS & COMPANY**

**REPORT OF THE DIRECTORS AND FINANCIAL STATEMENTS**

**31 December 2012**

**CONTENTS**

BOARD OF DIRECTORS AND SECRETARY	1
REPORT OF THE DIRECTORS	2
STATEMENT OF DIRECTORS' RESPONSIBILITIES	6
INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COUTTS & COMPANY	7
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME <i>for the year ended 31 December 2012</i>	8
BALANCE SHEETS <i>as at 31 December 2012</i>	9
STATEMENTS OF CHANGES IN EQUITY <i>for the year ended 31 December 2012</i>	10
CASH FLOW STATEMENTS <i>for the year ended 31 December 2012</i>	11
ACCOUNTING POLICIES	12
NOTES TO THE FINANCIAL STATEMENTS	21

**BOARD OF DIRECTORS AND SECRETARY**

**Directors:**

The Earl of Home CVO, CBE (Chairman, Non-executive director)  
Francesca Barnes (Non-executive director)  
Lord Waldegrave of North Hill, PC (Non-executive director)  
Gavin Frost (Executive director)  
Michael Morley (Executive director)  
Rory Tapner (Executive director)

**Secretary:**

Sally Anne Doyle

**Registered Office:**

440 Strand  
London  
WC2R 0QS

**Audit committee:**

The Earl of Home CVO, CBE (Chairman)  
John Collins  
Adam Holden  
Francesca Barnes

**Auditor:**

Deloitte LLP  
Chartered Accountants  
London

**Registered in Great Britain**

**REPORT OF THE DIRECTORS**

The directors of Coutts & Company ("the Bank") present their report, together with audited financial statements of the Bank and its subsidiaries (together "the Group") for the year ended 31 December 2012. The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), adopted by the European Union (EU).

**ACTIVITIES AND BUSINESS REVIEW****Principal Activities**

The principal activity of the Group is to provide a wide range of banking and financial services.

The Group continues to focus on its core activities of supplying wealth management and banking services to high net worth individuals and their businesses and will continue to concentrate on improving the quality and efficiency of the services provided.

The directors do not anticipate any material change in either the type or level of activities of the Group.

The Group is a subsidiary of The Royal Bank of Scotland Group Plc ("the RBS Group") which provides direction and access to all central resources it needs and determines policies in all key areas such as finance, risk, human resources or environment. For this reason, the directors believe that performance indicators specific to the Group are not necessary or appropriate for an understanding of the development, performance or position of the business. The annual reports of the RBS Group review these matters on a group basis. Copies can be obtained from Group Secretariat, RBS Gogarburn, Edinburgh EH12 1HQ, the Registrar of Companies or through the RBS Group's website.

**Business Review**

The directors are satisfied with the Group's performance during the year. The Group will be guided by its ultimate parent company in seeking further opportunities for growth.

The retained profit for the year was £88m (2011: £112m) and this was transferred to reserves.

*Financial performance*

The Group's financial performance is presented in the Statement of Comprehensive Income on page 8.

Income increased by £68m (2011: increased by £52m) and expenses increased by £90m (2011: increased by £60m).

After impairment provisions of £23m (2011: £11m) and a tax charge of £35m (2011: £45m), the profit after tax for the year was £88m (2011: £112m), a decrease of 21% on 2011.

At the end of the year, the consolidated balance sheet showed total assets of £24,940m (2011: £23,271m).

*Other matters*

The principal source of funds for the Bank is its core customer deposits gathered from its private clients. The underlying strength of the Bank is demonstrated by its performance. The Bank is a net provider of funds to other companies in the RBS Group. Customer accounts increased from £19,948m in December 2011 to £20,560m at the end of December 2012. The Bank's strong client focus is a key part of the funding strategy and continues to benefit the Group's funding position.

In 2007, following a review of the principal business of Coutts & Company Investment Management Limited, the Board decided that due to increasingly complex regulations it will no longer be able to undertake business for US resident clients. The business was made dormant in 2007 and will be wound up in 2013.

**REPORT OF THE DIRECTORS (continued)***Accounting policies*

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgements are included in the Accounting policies on pages 18 to 19.

*Risk management*

The major risks associated with the Group's businesses are market, liquidity, credit, regulatory and operational risk. The Group has established a comprehensive framework for managing these risks, which is continually evolving as the Group's business activities change in response to market, credit, product and other developments.

The Group's policies for managing each of these risks and its exposure thereto are detailed in Note 22 to the financial statements.

*Outlook*

The directors remain confident that the Bank is well positioned to meet the continuing challenges of the regulatory landscape, external market and customer environment. They consider the Group and the Bank to be in a stable financial position and confirm that it has adequate resources to continue in business for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the financial statements.

**Share capital**

Analysis of share capital can be found in Note 21 to the financial statements.

**Directors and secretaries**

The names of the current members of the Board of Directors are shown on page 1.

From 1 January 2012 to date the following changes have taken place:

<u>Directors</u>	<u>Appointed</u>	<u>Resigned</u>
Brian Hartzler		15/06/2012
Francesca Barnes	01/11/2012	
Lord Waldegrave of North Hill, PC	03/12/2012	

**Directors' indemnities**

In terms of Section 236 of the Companies Act 2006, all the directors listed on page 1 have been granted Qualifying Third Party Indemnity Provisions by the RBS Group.

**Employee Policies***Diversity and inclusion*

The Group has a range of policies and processes that extend through the employee life-cycle including recruitment, flexible working and support for ill-health and disability-related absence. Diversity performance is monitored and reviewed at Group and divisional executive level. This commitment extends beyond the Group including support of external charitable networks and encouraging the development of community engagement and supplier relationships.

Internally, the Group supports initiatives such as the Women in Business network.

*Employee communication*

Employee engagement is encouraged through a range of communication channels. These channels provide access to news and information in a number of ways, including the intranet, magazines, video, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Chief Executive and other senior executives regularly communicate with employees across a range of channels.

Details of the number of employees and related costs can be found in Note 3.

**REPORT OF THE DIRECTORS (continued)****Policy and practice on payment of creditors**

The Group follows the policy and practice on payment of creditors determined by the RBS Group, which is committed to maintaining a sound commercial relationship with its suppliers. Consequently, the policy is to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed.

As at 31 December 2012, there were 30 days creditors outstanding to unrelated parties (2011: 30 days).

**Charitable contributions**

During the year the Group made charitable and community investment donations in the United Kingdom totalling £615,250 (2011: £561,205). An annual payment of 0.5% of pre tax profit (minimum £100k) is made each year to the Coutts Charitable Trust, per a covenant in place with the charity. The Coutts Charitable Trust assists charitable bodies undertaking activities for the public benefit and is primarily concerned with relieving the needs of people. This is usually directed towards social needs in the London area but also wherever Coutts & Company has a presence.

No contributions were made to any political party (2011: £nil).

**Going concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position, including potential risks and uncertainties, are set out in the Business Review on pages 2 and 3.

The financial position of the Group, its cash flows, liquidity position, capital and funding sources are set out in the financial statements. In addition, Notes 22 and 23 to the financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to market, credit and liquidity risks.

The directors, having made such enquiries as they considered appropriate, having reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future, have prepared the financial statements on a going concern basis. In reaching their conclusion they considered the announcement of results by the RBS Group for the year ended 31 December 2012, approved on 27 February 2013, which were prepared on a going concern basis.

**Dividends**

An interim dividend of £100m was approved on 1 October 2012. A further two interim dividends of £50m each were approved on 14 May 2012 and 19 December 2012 (2011: £nil).

A dividend of £75m was paid from Coutts Finance Company to Coutts & Company in 2012 (2011: £nil).

**Post balance sheet events**

There have been no significant events between the year end and the date of approval of the financial statements which would require a change to, or disclosure in the financial statements.

**Disclosure of information to auditor**

Each of the directors at the date of approval of this report confirms that:

- in so far as the director is aware, there is no relevant audit information of which the Bank's auditor is unaware; and
- the director has taken all the steps he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Bank's auditor are aware of that information.

This confirmation is given and shall be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

**REPORT OF THE DIRECTORS (continued)**

**Auditor**

Deloitte LLP have expressed their willingness to continue in office as auditor. A resolution to re-appoint Deloitte LLP as the Bank's auditor will be proposed at the forthcoming Annual General Meeting.

By order of the Board:



Sally Anne Doyle  
Secretary

Date: 4 April 2013

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare such financial statements for each financial year. Under that law the directors have chosen to prepare the Group and Bank financial statements in accordance with IFRS as adopted by the EU. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Bank and of the profit or loss for that period. In preparing these financial statements International Accounting Standard ("IAS") 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions of the entity's financial position and performance; and
- make an assessment of the Group and Bank's ability to continue as a going concern.

The directors are responsible for keeping proper accounting records that are sufficient to show and explain the Group and Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Bank and to enable them to ensure that the financial statements comply with the requirements of the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that these financial statements comply with the aforementioned requirements.

By order of the Board:



Sally Anne Doyle  
Secretary

Date: 4 April 2013



## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COUTTS & COMPANY**

We have audited the financial statements of Coutts & Company ("the Bank") and its subsidiaries (together, "the Group") for the year ended 31 December 2012 which comprise the Consolidated Statement of Comprehensive Income, the Group and Bank Balance Sheets, the Group and Bank Statements of Changes in Equity, the Group and Bank Cash Flow Statements, the accounting policies and the related notes 1 to 33. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union and applied in accordance with the provision of the Companies Act 2006.

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditor**

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Bank's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the Group and the Bank's affairs as at 31 December 2012 and of the Group and Bank's profit for the year then ended;
- the financial statements have been properly prepared in accordance with IFRS as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

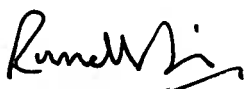
### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Russell Davis FCA (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom

Date: 4 April 2013

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME** for the year ended 31 December 2012

		<b>Group</b>	
	Notes	<b>2012</b>	<b>2011</b>
		<b>£'000</b>	<b>£'000</b>
Interest receivable		645,688	538,572
Interest payable		(265,035)	(232,808)
<b>Net interest income</b>	<b>1</b>	<b>380,653</b>	<b>305,764</b>
Fees and commissions receivable		202,315	201,074
Fees and commissions payable		(11,236)	(6,656)
Income from trading activities		19,830	22,530
Other operating income		919	1,867
<b>Non-interest income</b>	<b>2</b>	<b>211,828</b>	<b>218,815</b>
<b>Total income</b>		<b>592,481</b>	<b>524,579</b>
<b>Operating expenses</b>	<b>3</b>	<b>(446,044)</b>	<b>(355,635)</b>
<b>Operating profit before impairment losses</b>		<b>146,437</b>	<b>168,944</b>
Impairment loss on loans and advances	<b>10</b>	(23,387)	(11,480)
<b>Operating profit before tax</b>		<b>123,050</b>	<b>157,464</b>
Tax	<b>6</b>	(34,612)	(45,223)
<b>Profit for the year</b>		<b>88,438</b>	<b>112,241</b>
Foreign exchange movement		(88)	(130)
<b>Total comprehensive income for the year</b>		<b>88,350</b>	<b>112,111</b>

The accompanying accounting policies on pages 12 to 20 and the notes on pages 21 to 48 form an integral part of these financial statements.

**BALANCE SHEETS** as at 31 December 2012

		Group		Bank	
	Notes	2012 £'000	2011 £'000	2012 £'000	2011 £'000
<b>Assets</b>					
Cash and cash equivalents	9	3,572	2,690	3,472	2,590
Loans and advances to banks	9	14,384,935	12,838,241	14,390,279	12,840,668
Loans and advances to customers	9	10,406,759	10,284,551	10,275,647	10,129,107
Equity shares	9,11	10	10	10	10
Investment in Group undertakings	9,12	-	-	3,350	3,350
Intangible assets	9,13	24,479	17,299	24,479	17,299
Property, plant and equipment	9,14	9,396	10,572	9,396	10,572
Derivatives	9,15	43,701	48,368	43,701	48,368
Prepayments, accrued income and other assets	9,16	66,699	69,541	65,899	67,786
<b>Total assets</b>		<b>24,939,551</b>	<b>23,271,272</b>	<b>24,816,233</b>	<b>23,119,750</b>
<b>Liabilities</b>					
Deposit by banks	9	3,278,512	2,147,781	3,297,789	2,148,319
Customer accounts	9	20,560,232	19,947,797	20,560,232	19,947,797
Derivatives	9,15	43,596	48,067	43,596	48,067
Accruals, deferred income and other liabilities	9,17	258,195	217,573	222,280	185,050
Provisions for liabilities and charges	9,19	8,108	6,716	8,108	6,716
Subordinated liabilities	9,20	78,942	79,722	78,942	79,722
<b>Total liabilities</b>		<b>24,227,585</b>	<b>22,447,656</b>	<b>24,210,947</b>	<b>22,415,671</b>
<b>Equity</b>					
Shareholders' equity					
Called up share capital	21	41,333	41,333	41,333	41,333
Retained earnings		670,633	782,283	563,953	662,746
<b>Total equity</b>	9	<b>711,966</b>	<b>823,616</b>	<b>605,286</b>	<b>704,079</b>
<b>Total liabilities and equity</b>		<b>24,939,551</b>	<b>23,271,272</b>	<b>24,816,233</b>	<b>23,119,750</b>

The accompanying accounting policies on pages 12 to 20 and the notes on pages 21 to 48 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors 4 April 2013 and signed on its behalf by:

The Earl of Home CVO, CBE  
Chairman  
4 April 2013

Gavin Frost  
Executive Director  
4 April 2013

**STATEMENTS OF CHANGES IN EQUITY** for the year ended 31 December 2012

	Notes	Group		Bank	
		2012 £'000	2011 £'000	2012 £'000	2011 £'000
<b>Called up share capital</b>					
At 1 January and 31 December	21	41,333	41,333	41,333	41,333
<b>Retained Earnings</b>					
At 1 January		782,283	670,172	662,746	603,815
Profit for the year		88,438	112,241	101,295	59,064
Dividends paid	8	(200,000)	-	(200,000)	-
Exchange movement		(88)	(130)	(88)	(133)
At 31 December		670,633	782,283	563,953	662,746
<b>Shareholders' equity at 31 December</b>		<b>711,966</b>	<b>823,616</b>	<b>605,286</b>	<b>704,079</b>

The accompanying accounting policies on pages 12 to 20 and the notes on pages 21 to 48 form an integral part of these financial statements.

**CASH FLOW STATEMENTS** for the year ended 31 December 2012

	Notes	Group		Bank	
		2012 £'000	2011 £'000	2012 £'000	2011 £'000
<b>Operating activities</b>					
Operating profit for the year before tax	25	123,050	157,464	116,282	85,172
Adjustments for:					
Equity dividends received		-	-	(75,000)	-
Elimination of foreign exchange differences		208,097	202,569	208,097	202,566
Depreciation and amortisation		2,964	1,731	2,964	1,731
Losses on loans and advances written off		14,865	9,685	13,447	9,421
Other non-cash items		16,039	5,194	16,253	5,305
<b>Net cash inflows from trading activities</b>	25	365,015	376,643	282,043	304,195
Changes in operating assets and liabilities		143,804	(1,470,366)	133,020	(1,411,457)
<b>Net cash flows from operating activities before tax</b>		508,819	(1,093,723)	415,063	(1,107,262)
Tax paid	25	(1,800)	(54,416)	16,956	(40,877)
<b>Net cash flows from operating activities</b>		507,019	(1,148,139)	432,019	(1,148,139)
<b>Investing activities</b>					
Purchases of property, plant and equipment	14	(2,628)	(2,890)	(2,628)	(2,890)
Purchase of intangible asset	13	(8,812)	(12,542)	(8,812)	(12,542)
Proceed on disposals		2,472	91	2,472	91
Equity dividends received		-	-	75,000	-
<b>Net cash flows (from)/used in investing activities</b>		(8,968)	(15,341)	66,032	(15,341)
<b>Financing activities</b>					
Equity dividends paid		(200,000)	-	(200,000)	-
<b>Net cash flows used in financing activities</b>		(200,000)	-	(200,000)	-
Effects of exchange rate changes		(208,965)	(203,183)	(208,965)	(203,183)
<b>Net increase/(decrease) in cash and cash equivalents</b>		89,086	(1,366,663)	89,086	(1,366,663)
Cash and cash equivalents at 1 January		7,682,743	9,049,406	7,682,643	9,049,306
<b>Cash and cash equivalents at 31 December</b>	28	7,771,829	7,682,743	7,771,729	7,682,643

The accompanying accounting policies on pages 12 to 20 and the notes on pages 21 to 48 form an integral part of these financial statements.

**ACCOUNTING POLICIES****1. Presentation of financial statements**

The consolidated financial statements are prepared on a going concern basis and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together IFRS) as adopted by the European Union (EU).

The financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments that are designated as at fair value through profit or loss.

The Bank is incorporated in the UK and registered in England and Wales. The Group and Bank's financial statements are presented in accordance with the Companies Act 2006.

**2. Basis of consolidation**

The consolidated financial statements incorporate the financial statements of the Bank (Coutts & Company) and entities that are controlled by the Bank (its subsidiaries). Control exists where the Group has the power to govern the financial and operating policies of the entity; generally conferred by holding a majority of voting rights.

On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated financial statements at their fair value. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed. The interest of non-controlling shareholders is stated at their share of the fair value of the subsidiary's net assets.

The results of subsidiaries acquired are included in the Consolidated Statement of Comprehensive Income from the date control passes until the Group ceases to control them through a sale or significant change in circumstances. Changes in interest that do not result in a loss of control are recognised in equity.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared using uniform accounting policies.

**3. Revenue recognition**

Interest income on financial assets that are classified as loans and receivables and interest expense on financial liabilities other than those at fair value through profit or loss is determined using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities held for trading and financial liabilities designated as fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss together with dividends and interest receivable and payable.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. The fees are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

*Payment services:* this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account, monthly or quarterly in arrears. Income is accrued at period end for services provided but not charged.

**ACCOUNTING POLICIES (continued)****3. Revenue recognition (continued)**

*Card related services:* fees from credit card business include:

- Commission received from retailers for processing credit and debit card transactions: income is accrued to the Statement of Comprehensive Income as the service is performed;
- Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and automated teller machine networks. These fees are accrued once the transaction has taken place; and
- An annual fee payable by a credit card holder is deferred and taken to profit or loss over the period of the service i.e 12 months.

*Investment management fees:* fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue from these contracts is recognised.

*Fees and commissions payable:* Fees and commissions are payable in respect of services provided by third party intermediaries. These are charged through the profit and loss over the life of the underlying product.

**4. Pension and other post-retirement benefits**

The Royal Bank of Scotland Group plc provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value.

Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside profit or loss and presented in the Statement of Comprehensive Income.

There is no contractual agreement or policy on the way that the cost of The Royal Bank of Scotland Group plc defined benefit pension schemes and healthcare plans are allocated to the Group. Therefore the Coutts Group account for the charges it incurs as payments to a defined contribution scheme.

Contributions to defined contribution pension schemes are recognised in the Statement of Comprehensive Income when payable.

**5. Internally-generated intangible assets – research and development expenditure**

Expenditure on research activities is recognised as an expense in the period in which it is incurred. An internally-generated intangible asset arising from company development is recognised only if all of the following conditions are met:

- an asset is created that can be identified, such as software;
- it is probable that the asset created will generate future economic benefits; and
- the development costs can be measured reliably.

Where these conditions are not met, development expenditure is recognised as an expense in the period in which it is incurred. Internally generated intangible assets are amortised on a straight-line basis over their useful economic life.

The amortisation period for software development costs incurred on the Group and Bank's Avaloq development is 8 years. The carrying value of intangible assets is assessed for impairment as described below in accounting policy 7.

**ACCOUNTING POLICIES (continued)****6. Property, plant and equipment**

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and accumulated impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment over their estimated useful lives.

The depreciable amount is the cost of an asset less its residual value. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	Unexpired period of the lease
Computer equipment	5 years
Motor vehicles	5 years
Other plant and equipment	10 to 15 years

The residual value and useful life of property, plant and equipment are reviewed at each balance sheet date and updated for any changes.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

**7. Impairment of intangible assets and property, plant and equipment**

At each reporting date, the Group assesses whether there is any indication that its intangible assets or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss, if any. Irrespective of any indications of impairment, intangible assets with indefinite useful lives are tested annually for impairment by comparing their carrying value with their recoverable amount. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been reflected in the estimation of future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised.

**8. Foreign currencies**

The Group's consolidated financial statements are presented in Sterling which is the functional currency of the Bank.

Transactions in foreign currencies are translated into Sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are reported in income from trading activities. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into Sterling at foreign exchange rates ruling at the dates the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example, equity shares, which are included in the available-for-sale reserve in equity unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations are translated into Sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into Sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on translation of foreign operations are recognised directly in equity and included in profit or loss on its disposal.



**ACCOUNTING POLICIES (continued)****9. Leases**

Contracts to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer. Other contracts to lease assets are classified as operating leases.

Rental income from operating leases is credited to the Statement of Comprehensive Income on a receivable basis over the term of the lease. Operating lease assets are included within property, plant and equipment and depreciated over their useful lives (see accounting policy 6).

**10. Provisions and contingent liabilities**

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle that obligation at the balance sheet date, and are discounted to present value where the effect is material.

**11. Taxation**

Income tax expense or income, comprising current tax and deferred tax, is recorded in the Income Statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate. Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in income or in equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

**12. Financial assets**

On initial recognition financial assets are classified into held for trading; loans and receivables or available-for-sale financial assets.

*Held-for-trading* - a financial asset is classified as held for trading if it is acquired principally for the sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative. Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

*Loans and receivables* - non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables, except those that are classified as available-for-sale or as held-for-trading. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at adjusted cost using the effective interest method (see accounting policy 3) less any impairment losses.

*Available-for-sale* - financial assets that are not classified as loans and receivables or held for trading are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of monetary available-for-sale financial assets denominated in a foreign currency are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy 3). Other changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

**ACCOUNTING POLICIES (continued)****13. Impairment of financial assets**

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables is impaired. Financial assets are impaired and an impairment loss is incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Impairment losses are recognised through the Statement of Comprehensive Income. Any reversals are credited to the Statement of Comprehensive Income.

**14. Financial liabilities**

On initial recognition financial liabilities are classified into designated as at fair value through profit or loss; or amortised cost.

*Designated as at fair value through profit or loss* - financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value with transaction costs being recognised in profit or loss and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated at fair value through profit or loss are recognised in profit or loss as they arise.

*Amortised cost* - All other financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 3).

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price times the number of units of the instrument held or issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities.

**15. Netting**

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

**16. Derivatives**

Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is carried at fair value through profit or loss.

Gains and losses arising from changes in fair value of a derivative are recognised as they arise in profit or loss.

**17. Share-based payments**

The Royal Bank of Scotland Group plc awards options over shares to its employees under various share option schemes. IFRS 2 'Share-based Payment' is applied by The Royal Bank of Scotland Group plc to grants made under these schemes after 7 November 2002 that had not vested on 1 January 2010. The Royal Bank of Scotland Group plc recognises an expense for these transactions with its employees based on the fair value on the date the options are granted. It includes the cost of these awards in determining any recharges of employee costs it makes to UK subsidiaries in the Group.

**ACCOUNTING POLICIES (continued)****18. Cash and cash equivalents**

In the cash flow statement, cash and cash equivalents comprises cash on hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

**19. Investment in Group undertakings**

The Bank's investments in its subsidiaries are stated at cost less any accumulated impairment losses.

**ACCOUNTING POLICIES (continued)****Critical accounting policies and key sources of estimation uncertainty**

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard of interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of financial statements.

The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

*Loan impairment provisions*

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired where there is objective evidence that events since the loan was granted have 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 at the loan's original effective interest rate.

At 31 December 2012, gross loans and advances to customers totalled £10,457m (2011: £10,321m) and customer loan impairment provisions amounted to £50m (2011: £37m).

There are two components to the Group's loan impairment provisions: individual and collective.

*Individual component* – all loans are individually assessed for impairment. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security; both readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

*Collective component* – this is made up of loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). The methodology by which the Latent Loss Reserve is calculated entails a statistical estimation of existing but unidentified defaults, based upon the level of identified individual impairments and the emergence period (the average time taken for current impaired loans to be recognised and provided for under the individual impairment assessment process).

*Fair value – financial instruments*

Financial instruments classified as designated as at fair value through profit or loss, held-for-trading and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. Derivative assets and derivative liabilities are shown separately on the face of the balance sheets. Gains or losses arising from changes in fair value of financial instruments classified as held for trading are included in the Statement of Comprehensive Income. Unrealised gains and losses on available-for-sale financial assets are recognised directly in other comprehensive income and accumulated in equity, unless an impairment loss is recognised.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values are determined by reference to observable market prices where available and reliable. Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters, including interest rate yield curves, option volatilities and currency rates.

The Group's derivative products include swaps, forwards, futures and options. Exchange traded instruments are valued using quoted prices. The fair value of over-the-counter instruments is derived from pricing models which take account of contract terms, including maturity, as well as quoted market parameters such as interest rates and volatilities. Most of the Group's pricing models do not entail material subjectivity because the methodologies utilised do not incorporate significant judgement and the parameters included in the models can be calibrated to actively quoted market prices. Values established from pricing models are adjusted for credit risk, liquidity risk and future operational costs.

**ACCOUNTING POLICIES (continued)****Critical accounting policies and key sources of estimation uncertainty (continued)***Fair value – financial instruments (continued)*

A negligible proportion of the Group's trading derivatives are valued directly from quoted prices, the majority being valued using appropriate valuation techniques. The fair value of substantially all securities' positions carried at fair value is determined directly from quoted prices.

Details of financial instruments carried at fair value are given in Note 9 to the financial statements.

*Forbearance*

Forbearance policies are the main response to managing customers in financial difficulty and are deployed through the Group's forbearance initiative. Forbearance is applied to customers where temporary or longer term relief is offered through the renegotiation of the original contract although on terms not generally available on a commercial basis. This may include offering contract revisions by various means including reduced repayment, interest only arrangements, payment moratorium, term extension, lifetime reduced repayment; these forbearance arrangements are subject to heightened monitoring.

Forbearance offered by the Group on loans where an impairment loss provision has been previously recognised will result in such loans retaining their classification as non-performing. Where the customer met the loan terms prior to modification and there is a realistic expectation that the customer will adhere to the forbearance terms, these loans will be classified as performing loans.

**Accounting developments**

A number of IFRSs and amendments to IFRS were in issue at 31 December 2012 that had effective dates of 1 January 2013 or later.

*Effective for 2013*

The following IFRSs and amendments to IFRS have an effective date of 1 January 2013:

IFRS 10 'Consolidated Financial Statements' replaces SIC-12 'Consolidation - Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity. IFRS 10 requires retrospective application. Implementation of IFRS 10 will not have a material effect on the Group's financial statements.

IFRS 11 'Joint Arrangements', which supersedes IAS 31 'Interests in Joint Ventures', distinguishes between joint operations and joint ventures. Joint operations are accounted for by the investor recognising its assets and liabilities including its share of any assets held and liabilities incurred jointly and its share of revenues and costs. Joint ventures are accounted for in the investor's consolidated accounts using the equity method. IFRS 11 requires retrospective application. Implementation of IFRS 11 will not have a material effect on the Group's financial statements.

IFRS 12 'Disclosure of Interests in Other Entities' covers disclosures for entities reporting under IFRS 10 and IFRS 11 replacing those in IAS 28 and IAS 27. Entities are required to disclose information that helps financial statement readers evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries, in associates and joint arrangements and in unconsolidated structured entities. Implementation of IFRS 12 will not have a material effect on the Group's financial statements.

IAS 27 'Separate Financial Statements' comprises those parts of the existing IAS 27 that deal with separate financial statements and IAS 28 'Investments in Associates and Joint Ventures' covers joint ventures as well as associates; both must be accounted for using the equity method. The mechanics of the equity method are unchanged. These two revised standards have no effect on the Group's financial statements.

Although IFRS 10-12 (as amended) and revised IAS 27 and IAS 28 have an effective date of 1 January 2013, they have been endorsed by the EU for application from 1 January 2014. However, early adoption is permitted and the Group implemented these standards from 1 January 2013.

IFRS 13 'Fair Value Measurement' sets out a single IFRS framework for defining and measuring fair value and requiring disclosures about fair value measurements. Implementation of IFRS 13 will not have a material effect on the Group's financial statements.

**ACCOUNTING POLICIES (continued)****Accounting developments (continued)**

'Disclosures-Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)' amended IFRS 7 to require disclosures about the effects and potential effects on an entity's financial position of offsetting financial assets and financial liabilities and related arrangements. Implementation of amendments to IFRS 7 will not have a material effect on the Group's financial statements.

IAS 19 'Employee Benefits' (revised) requires: the immediate recognition of all actuarial gains and losses eliminating the "corridor approach"; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 (revised) will not have a material effect on the Group's financial statements.

Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' require items that will never be recognised in profit or loss to be presented separately in other comprehensive income from those items that are subject to subsequent reclassification. Implementation of the amendments to IAS 1 will not have a material effect on the Group's financial statements.

'Annual Improvements 2009-2011 Cycle' makes a number of minor changes to IFRSs. These will not have a material effect on the Group's financial statements.

**Effective after 2013**

In October 2012, the IASB issued 'Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)'. The amendments apply to 'investment entities': entities whose business is to invest funds solely for returns from capital appreciation, investment income or both and which evaluate the performance of their investments on a fair value basis. The amendments provide an exception to IFRS 10 by requiring investment entities to measure their subsidiaries (other than those that provide services related to the entity's investment activities) at fair value through profit or loss, rather than consolidate them. The amendments are effective from 1 January 2014.

In December 2011, the IASB issued 'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)'. The amendments add application guidance to IAS 32 to address inconsistencies identified in applying some of the standard's criteria for offsetting financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after 1 January 2014 and must be applied retrospectively.

In November 2009, the IASB issued IFRS 9 'Financial Instruments' simplifying the classification and measurement requirements in IAS 39 in respect of financial assets. The standard reduces the measurement categories for financial assets to two: fair value and amortised cost. A financial asset is classified on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. Only assets with contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on principal and which are held within a business model whose objective is to hold assets in order to collect contractual cash flows are classified as amortised cost. All other financial assets are measured at fair value. Changes in the value of financial assets measured at fair value are generally taken to profit or loss.

In October 2010, IFRS 9 was updated to include requirements in respect of the classification and measurement of liabilities. These do not differ markedly from those in IAS 39 except for the treatment of changes in the fair value of financial liabilities that are designated as at fair value through profit or loss attributable to own credit; these must be presented in other comprehensive income.

In December 2011, the IASB issued amendments to IFRS 9 and to IFRS 7 'Financial Instruments: Disclosures' delaying the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 and introducing revised transitional arrangements including additional transition disclosures. If an entity implements IFRS 9 in 2012 the amendments permit it either to restate comparative periods or to provide the additional disclosures. Additional transition disclosures must be given if implementation takes place after 2012.

IFRS 9 makes major changes to the framework for the classification and measurement of financial instruments and will have a significant effect on the Group's financial statements. The Group is assessing the effect of IFRS 9 which will depend on the results of IASB's reconsideration of IFRS 9's classification and measurement requirements and the outcome of the other phases in the development of IFRS 9.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**1. Net interest income**

	<b>Group</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
Interest receivable from Group undertakings	329,370	217,145
Other interest receivable	316,318	321,427
Interest receivable	645,688	538,572
Interest payable to Group undertakings	(87,827)	(45,484)
Other interest payable	(177,208)	(187,324)
Interest payable	(265,035)	(232,808)
Net interest income	380,653	305,764

**2. Non-interest income**

	<b>Group</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
Fees and commission receivable	202,315	201,074
Fees and commission payable	(11,236)	(6,656)
Income from trading activities:		
Foreign exchange (1)	19,830	22,530
Other operating income	919	1,867
Non-interest income	211,828	218,815

(1) The analysis of trading income is based on how the business is organised and the underlying risks managed. Foreign exchange includes spot and forward foreign exchange contracts, interest rate swaps, currency swaps, futures and options

**3. Operating expenses**

	<b>Group</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
Wages and salaries	175,854	151,700
Social security costs	16,194	14,561
Pension costs (see Note 4)	14,912	13,507
Staff costs	206,960	179,768
Intangible asset amortisation (see Note 13)	1,632	-
Property, plant and equipment depreciation (see Note 14)	1,332	1,731
Depreciation and amortisation	2,964	1,731
Other operating charges	96,104	72,340
Premises and equipment	16,486	22,941
Other administrative expenses	106,255	72,917
Provision for liabilities and charges (see Note 19)	17,275	5,938
Other expenses	236,120	174,136
Operating expenses	446,044	355,635

The auditor's remuneration for statutory audit work was £128,000 for the Group (2011: £128,000). Remuneration paid to the auditor for non-audit work for the Group was £32,000 (2011: £96,000).

Operating expenses for 2011 includes £15m of fines levied by the FSA on the Group as a result of failures in business processes and controls identified during 2011.

The average number of persons employed by the Group and the Bank during the year was made up as follows:

	<b>Group and Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>Number</b>	<b>Number</b>
<b>Employee numbers</b>		
Managers	692	670
Clerical and other staff	1,615	1,562
	2,307	2,232

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**4. Pension costs**

Eligible employees of the Bank can participate in membership of RBS Group plc operated pension schemes. The principal defined benefit scheme was The Royal Bank of Scotland Group Pension Fund (the "Main scheme"). The Main scheme was closed to new entrants in October 2006 and since then employees have been offered membership of The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme. Detailed disclosure of the RBS Group's pension schemes is available in the RBS Group's Annual Report and Accounts 2012.

**5. Emoluments of directors**

	2012 £'000	2011 £'000
Non-executive directors - emoluments	23	100
Chairman and executive directors - emoluments	1,134	1,152
	<b>1,157</b>	<b>1,252</b>

Number of directors to whom retirement benefits are accruing in respect of qualifying service:

- money purchase schemes	1	2
- defined benefit schemes	1	1

The total emoluments of the highest paid director were £455,806 (2011: £433,327). The accrued pension attributable to that director was £66,300 (2011: £66,300). No shares were received or receivable in respect of qualifying services under long-term incentive schemes.

Total emoluments include bonuses paid in early 2013 which relate to performance for the year 2012.

**6. Tax**

	Group 2012 £'000	2011 £'000
<b>Current taxation:</b>		
United Kingdom corporation tax at 24.5% (2011: 26.5%)		
Charge for the year	27,791	45,367
Under/(over) provision in respect of prior periods	7,501	(135)
Total current taxation	<b>35,292</b>	<b>45,232</b>
<b>Deferred taxation:</b>		
Origination and reversal of timing differences	4,272	1,833
Over provision in respect of prior periods	(4,952)	(1,842)
Total deferred taxation	<b>(680)</b>	<b>(9)</b>
Tax charge for the year	<b>34,612</b>	<b>45,223</b>

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 24.5% (2011: 26.5%) as follows:

	Group 2012 £'000	2011 £'000
<b>Operating profit before tax</b>	<b>123,050</b>	<b>157,464</b>
<b>Expected tax charge</b>	<b>30,147</b>	<b>41,728</b>
<i>Factors affecting the charge for the year:</i>		
Disallowable expenses	746	4,602
Non-qualifying depreciation	132	234
Other short-term timing differences	1,038	636
Prior period adjustments	2,549	(1,977)
Actual tax charge for the year	<b>34,612</b>	<b>45,223</b>

The effective tax rate for the year was 28.13% (2011: 28.72%).

In recent years the UK Government has steadily reduced the rate of UK corporation tax, with the latest enacted rate standing at 23% with effect from 1 April 2013. Further reductions of the rate to 21% with effect from 1 April 2014 and 20% from 1 April 2015 were announced on 5 December 2012 and 20 March 2013 respectively, but not substantively enacted at the balance sheet date. Accordingly, the closing deferred tax assets and liabilities have been calculated at 23%.



**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**7. Profit dealt with in the financial statements of the bank**

In accordance with the exemption contained within Section 408(3) of the Companies Act 2006 the primary financial statements of the Bank do not include a Statement of Comprehensive Income. Included within Group profit after tax at 31 December 2012 is £101,295k (2011: £59,064k) attributable to the operations of the Bank.

**8. Ordinary Dividends**

	<b>Group and Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
Interim dividends paid	<b>200,000</b>	-

Interim dividends were approved as follows, £50m approved on 14 May 2012, £100m on 1 October 2012 and £50m on 19 December 2012 (2011: nil).

**9. Financial instruments**

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in accordance with IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	<b>Group</b>					<b>Total</b>
	<b>Designated as at fair value through profit or loss</b>	<b>Available- for-sale</b>	<b>Loans and receivables</b>	<b>Other (Amortised cost)</b>	<b>Non financial assets/ liabilities</b>	
<b>2012</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Assets</b>						
Cash and cash equivalents	-	-	3,572	-	-	3,572
Loans and advances to banks <sup>(1)</sup>	-	-	14,384,935	-	-	14,384,935
Loans and advances to customers	-	-	10,406,759	-	-	10,406,759
Equity shares	-	10	-	-	-	10
Intangible assets	-	-	-	-	24,479	24,479
Property, plant and equipment	-	-	-	-	9,396	9,396
Derivatives	43,701	-	-	-	-	43,701
Other assets, prepayments and accrued income	-	-	28,766	-	37,933	66,699
	<b>43,701</b>	<b>10</b>	<b>24,824,032</b>	<b>-</b>	<b>71,808</b>	<b>24,939,551</b>
<b>Liabilities</b>						
Deposit by banks <sup>(2)</sup>	-	-	-	3,278,512	-	3,278,512
Customer accounts	4,293	-	-	20,555,939	-	20,560,232
Derivatives	43,596	-	-	-	-	43,596
Other liabilities, accruals and deferred income	-	-	-	-	258,195	258,195
Provisions for liabilities and charges	-	-	-	-	8,108	8,108
Subordinated liabilities	-	-	-	78,942	-	78,942
	<b>47,889</b>	<b>-</b>	<b>-</b>	<b>23,913,393</b>	<b>266,303</b>	<b>24,227,585</b>
<b>Equity</b>						<b>711,966</b>
						<b>24,939,551</b>

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**9. Financial instruments (continued)**

	Group					Total £'000
	Designated as at fair value through profit or loss £'000	Available-for- sale £'000	Loans and receivables £'000	Other (Amortised cost) £'000	Non financial assets/ liabilities £'000	
<b>2011</b>						
<b>Assets</b>						
Cash and cash equivalents	-	-	2,690	-	-	2,690
Loans and advances to banks <sup>(1)</sup>	-	-	12,838,241	-	-	12,838,241
Loans and advances to customers	-	-	10,284,551	-	-	10,284,551
Equity shares	-	10	-	-	-	10
Intangible assets	-	-	-	-	17,299	17,299
Property, plant and equipment	-	-	-	-	10,572	10,572
Derivatives	48,368	-	-	-	-	48,368
Other assets, prepayments and accrued income	-	-	19,351	-	50,190	69,541
	<b>48,368</b>	<b>10</b>	<b>23,144,833</b>	<b>-</b>	<b>78,061</b>	<b>23,271,272</b>
<b>Liabilities</b>						
Deposit by banks <sup>(2)</sup>	-	-	-	2,147,781	-	2,147,781
Customer accounts	39,600	-	-	19,908,197	-	19,947,797
Derivatives	48,067	-	-	-	-	48,067
Other liabilities, accruals and deferred income	-	-	-	-	217,573	217,573
Provisions for liabilities and charges	-	-	-	-	6,716	6,716
Subordinated liabilities	-	-	-	79,722	-	79,722
	<b>87,667</b>	<b>-</b>	<b>-</b>	<b>22,135,700</b>	<b>224,289</b>	<b>22,447,656</b>
<b>Equity</b>						<b>823,616</b>
						<b>23,271,272</b>

(1) Includes items in the course of collection from other banks of Group £4,737k (2011: £8,524k)

(2) Includes items in the course of transmission to other banks of Group £4,015k (2011: £2,457k)

	Bank					Total £'000
	Designated as at fair value through profit or loss £'000	Available- for-sale £'000	Loans and receivables £'000	Other (Amortised cost) £'000	Non financial assets/ liabilities £'000	
<b>2012</b>						
<b>Assets</b>						
Cash and cash equivalents	-	-	3,472	-	-	3,472
Loans and advances to banks <sup>(1)</sup>	-	-	14,390,279	-	-	14,390,279
Loans and advances to customers <sup>(1)</sup>	-	-	10,275,647	-	-	10,275,647
Equity shares	-	10	-	-	-	10
Investment in Group undertakings	-	-	-	-	3,350	3,350
Intangible assets	-	-	-	-	24,479	24,479
Property, plant and equipment	-	-	-	-	9,396	9,396
Derivatives	43,701	-	-	-	-	43,701
Other assets, prepayments and accrued income	-	-	28,766	-	37,133	65,899
	<b>43,701</b>	<b>10</b>	<b>24,698,164</b>	<b>-</b>	<b>74,358</b>	<b>24,816,233</b>
<b>Liabilities</b>						
Deposit by banks <sup>(2)</sup>	-	-	-	3,297,789	-	3,297,789
Customer accounts	4,293	-	-	20,555,939	-	20,560,232
Derivatives	43,596	-	-	-	-	43,596
Other liabilities, accruals and deferred income	-	-	-	-	222,280	222,280
Provisions for liabilities and charges	-	-	-	-	8,108	8,108
Subordinated liabilities	-	-	-	78,942	-	78,942
	<b>47,889</b>	<b>-</b>	<b>-</b>	<b>23,932,670</b>	<b>230,388</b>	<b>24,210,947</b>
<b>Equity</b>						<b>605,286</b>
						<b>24,816,233</b>

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**9. Financial instruments (continued)**

	<b>Bank</b>					<b>Total</b>
	Designated as at fair value through profit or loss £'000	Available-for- sale £'000	Loans and receivables £'000	Other (Amortised cost) £'000	Non financial assets/ liabilities £'000	
<b>2011</b>						
<b>Assets</b>						
Cash and cash equivalents	-	-	2,590	-	-	2,590
Loans and advances to banks <sup>(1)</sup>	-	-	12,840,668	-	-	12,840,668
Loans and advances to customers <sup>(1)</sup>	-	-	10,129,107	-	-	10,129,107
Equity shares	-	10	-	-	-	10
Investment in Group undertakings	-	-	-	-	3,350	3,350
Intangible assets	-	-	-	-	17,299	17,299
Property, plant and equipment	-	-	-	-	10,572	10,572
Derivatives	48,368	-	-	-	-	48,368
Other assets, prepayments and accrued income	-	-	19,351	-	48,435	67,786
	<b>48,368</b>	<b>10</b>	<b>22,991,716</b>	<b>-</b>	<b>79,656</b>	<b>23,119,750</b>
<b>Liabilities</b>						
Deposit by banks <sup>(2)</sup>	-	-	-	2,148,319	-	2,148,319
Customer accounts	39,600	-	-	19,908,197	-	19,947,797
Derivatives	48,067	-	-	-	-	48,067
Other liabilities, accruals and deferred income	-	-	-	-	185,050	185,050
Provisions for liabilities and charges	-	-	-	-	6,716	6,716
Subordinated liabilities	-	-	-	79,722	-	79,722
	<b>87,667</b>	<b>-</b>	<b>-</b>	<b>22,136,238</b>	<b>191,766</b>	<b>22,415,671</b>
<b>Equity</b>						<b>704,079</b>
						<b>23,119,750</b>

(1) Includes amounts due from subsidiaries

(2) Includes amounts due to subsidiaries

The following table shows the financial instruments carried at fair value:

	<b>Group and Bank</b>					
	Level 1 <sup>(1)</sup> £'000	2012 Level 2 <sup>(2)</sup> £'000	Level 3 <sup>(3)</sup> £'000	2011 Level 1 £'000	Level 2 £'000	Level 3 £'000
<b>Assets</b>						
Derivatives	-	43,701	-	-	48,368	-
Equity shares	-	10	-	-	10	-
	-	<b>43,711</b>	-	-	<b>48,378</b>	-
<b>Liabilities</b>						
Deposits by banks and customers	-	4,293	-	-	39,600	-
Derivatives	-	43,596	-	-	48,067	-
	-	<b>47,889</b>	-	-	<b>87,667</b>	-

(1) Valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares, certain exchange-traded derivatives, G10 government securities and certain US agency securities.

(2) Valued using techniques based significantly on observable market data. Instruments in this category are valued using:

- quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or
- valuation techniques where all the inputs that have significant effect on the valuation are directly or indirectly based on observable market data

The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include most government securities, investment-grade corporate bonds, certain mortgage products, certain bank and bridge loans, repos and reverse loans, less liquid listed equities, state and municipal obligations, most physical commodities, investment contracts issued by the Group's life assurance businesses and certain money market securities and loan commitments and most OTC derivatives.

(3) Instruments in this category have been valued using a valuation technique where at least one input (which could have a significant effect on the instruments valuation) is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**9. Financial instruments (continued)**

The following tables show the carrying values and the fair values of financial instruments on the balance sheet carried at amortised cost:

	<b>Group</b>			
	<b>2012</b> <b>Carrying value</b> <b>£'000</b>	<b>2012</b> <b>Fair value</b> <b>£'000</b>	<b>2011</b> <b>Carrying value</b> <b>£'000</b>	<b>2011</b> <b>Fair value</b> <b>£'000</b>
<b>Financial assets</b>				
Cash and cash equivalents	<b>3,572</b>	<b>3,572</b>	2,690	2,690
Loans and advances to banks				
Loans and receivables	<b>14,384,935</b>	<b>14,384,935</b>	12,838,241	12,838,241
Loans and advances to customers				
Loans and receivables	<b>10,406,759</b>	<b>10,476,345</b>	10,284,551	10,286,059
<b>Financial liabilities</b>				
Deposit by banks	<b>3,278,512</b>	<b>3,278,512</b>	2,147,781	2,147,781
Customer accounts	<b>20,555,939</b>	<b>20,555,939</b>	19,908,197	19,908,197
Subordinated liabilities	<b>78,942</b>	<b>78,942</b>	79,722	79,722

	<b>Bank</b>			
	<b>2012</b> <b>Carrying value</b> <b>£'000</b>	<b>2012</b> <b>Fair value</b> <b>£'000</b>	<b>2011</b> <b>Carrying value</b> <b>£'000</b>	<b>2011</b> <b>Fair value</b> <b>£'000</b>
<b>Financial assets</b>				
Cash and cash equivalents	<b>3,472</b>	<b>3,472</b>	2,590	2,590
Loans and advances to banks				
Loans and receivables	<b>14,390,279</b>	<b>14,390,279</b>	12,840,668	12,840,668
Loans and advances to customers				
Loans and receivables	<b>10,275,647</b>	<b>10,270,674</b>	10,129,107	10,125,048
<b>Financial liabilities</b>				
Deposit by banks	<b>3,297,789</b>	<b>3,297,789</b>	2,148,319	2,148,319
Customer accounts	<b>20,555,939</b>	<b>20,555,939</b>	19,908,197	19,908,197
Subordinated liabilities	<b>78,942</b>	<b>78,942</b>	79,722	79,722

The fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates.

Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement. As a wide range of valuation techniques are available, it may be inappropriate to compare the Group's fair value information to independent markets or other financial institutions' fair values.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are set out below:

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2012***9. Financial instruments (continued)**

The fair value of financial instruments which are of short maturity (3 months or less) approximates their carrying value. This applies mainly to cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks and demand deposits.

The Group uses a number of methodologies to determine the fair values of financial instruments for which observable prices in active markets for identical instruments are not available. These techniques include: relative value methodologies based on observable prices for similar instruments; present value approaches where future cash flows from the asset or liability are estimated and then discounted using a risk-adjusted interest rate; option pricing models (such as Black-Scholes or binomial option pricing models) and simulation models such as Monte-Carlo.

The principal inputs to these valuation techniques are listed below. Values between and beyond available data points are obtained by interpolation and extrapolation. When utilising valuation techniques, the fair value can be significantly affected by the choice of valuation model and by underlying assumptions concerning factors such as the amounts and timing of cash flows, discount rates and credit risk.

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.
- Interest rates - these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.

**Loans and advances to banks and customers**

Fair value is estimated by grouping loans into homogeneous portfolios and applying a discount rate to the cash flows. The discount rate is based on the market rate applicable at the balance sheet date for a similar portfolio with similar maturity and credit risk characteristics.

**Deposits by banks and customer accounts**

The fair values of deposits are estimated using discounted cash flow valuation techniques.

**Subordinated liabilities**

Fair values are determined using quoted prices where available or by reference to valuation techniques and adjusting for own credit spreads where appropriate.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**9. Financial instruments (continued)****Remaining Maturity**

	<b>Group</b>		<b>Total £'000</b>
	<b>Less than 12 months £'000</b>	<b>More than 12 months £'000</b>	
<b>2012</b>			
<b>Assets</b>			
Cash and cash equivalents	3,572	-	3,572
Loans and advances to banks	14,384,935	-	14,384,935
Loans and advances to customers	4,229,346	6,177,413	10,406,759
<b>Liabilities</b>			
Deposits by banks	3,278,512	-	3,278,512
Customer accounts	19,677,620	882,612	20,560,232
Subordinated liabilities	78,942	-	78,942

	<b>Group</b>		<b>Total £'000</b>
	<b>Less than 12 months £'000</b>	<b>More than 12 months £'000</b>	
<b>2011</b>			
<b>Assets</b>			
Cash and cash equivalents	2,690	-	2,690
Loans and advances to banks	12,838,241	-	12,838,241
Loans and advances to customers	5,096,397	5,188,154	10,284,551
<b>Liabilities</b>			
Deposits by banks	2,147,781	-	2,147,781
Customer accounts	19,213,440	734,357	19,947,797
Subordinated liabilities	79,722	-	79,722

	<b>Bank</b>		<b>Total £'000</b>
	<b>Less than 12 months £'000</b>	<b>More than 12 months £'000</b>	
<b>2012</b>			
<b>Assets</b>			
Cash and cash equivalents	3,472	-	3,472
Loans and advances to banks	14,390,279	-	14,390,279
Loans and advances to customers	7,451,661	2,823,986	10,275,647
<b>Liabilities</b>			
Deposits by banks	3,297,789	-	3,297,789
Customer accounts	19,676,730	883,502	20,560,232
Subordinated liabilities	78,942	-	78,942

	<b>Bank</b>		<b>Total £'000</b>
	<b>Less than 12 months £'000</b>	<b>More than 12 months £'000</b>	
<b>2011</b>			
<b>Assets</b>			
Cash and cash equivalents	2,590	-	2,590
Loans and advances to banks	12,840,668	-	12,840,668
Loans and advances to customers	7,677,934	2,451,173	10,129,107
<b>Liabilities</b>			
Deposits by banks	2,148,319	-	2,148,319
Customer accounts	19,213,440	734,357	19,947,797
Subordinated liabilities	79,722	-	79,722

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**10. Financial Assets – impairments**

The following table shows the movement in the provision for loans and advances.

	<b>Group</b>		<b>Bank</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>Total</b>	<b>Total</b>	<b>Total</b>	<b>Total</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
At 1 January	36,807	27,865	35,442	26,654
Amounts written off	(8,522)	(1,795)	(8,522)	(1,795)
Charge to the income statement	23,387	11,480	21,969	11,216
Unwind of discount	(1,236)	(743)	(1,022)	(633)
At 31 December	50,436	36,807	47,867	35,442
Loans and advances to banks	-	1,524	-	1,524
Loans and advances to customers	50,436	35,283	47,867	33,918
Group total	50,436	36,807	47,867	35,442

The following tables show an analysis of past due but not impaired i.e. excluding financial assets requiring an individual or collective (but not latent) provision.

	<b>Group</b>				
	<b>Past due</b>	<b>Past due</b>	<b>Past due</b>	<b>Past due</b>	
	<b>1 to 29</b>	<b>30 to 59</b>	<b>60 to 89</b>	<b>90 days</b>	
	<b>days</b>	<b>days</b>	<b>days</b>	<b>and more</b>	
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>Total</b>
<b>2012</b>					<b>£'000</b>
Loans and advances to customers	13,099	514	6,723	11,305	31,641

	<b>Group</b>				
	<b>Past due</b>	<b>Past due</b>	<b>Past due</b>	<b>Past due</b>	
	<b>1 to 29</b>	<b>30 to 59</b>	<b>60 to 89</b>	<b>90 days and</b>	
	<b>days</b>	<b>days</b>	<b>days</b>	<b>more</b>	
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>Total</b>
<b>2011</b>					<b>£'000</b>
Loans and advances to customers	27,622	13,721	14,990	22,498	78,831

**11. Equity shares**

	<b>Group and Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>Unlisted</b>	<b>Unlisted</b>
	<b>£'000</b>	<b>£'000</b>
Investment securities:		
Available-for-sale	10	10
	<b>Equity holding</b>	
	<b>2012</b>	<b>2011</b>
	<b>%</b>	<b>%</b>
The principal equity shares are:		
VocaLink Holdings Limited £1 Shares	0.027	0.027

As at 31 December 2012 Coutts & Company hold 36,024 shares in VocaLink Limited (2011: 36,024 shares). The fair value of the investment in VocaLink is based on the value attributed to each share as per the VocaLink Holdings Limited rights issue of May 2009. There is no active market for these shares.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**12. Investment in Group undertakings**

	<b>Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
At 1 January and 31 December	<b>3,350</b>	<b>3,350</b>

The Bank owns 100% of the ordinary share capital and voting rights of Coutts Finance Co, 440 Strand, London WC2R 0QS, which is an unlisted company incorporated in Great Britain and registered in England and Wales. Its principal business is the provision of residential mortgages in the United Kingdom.

The Bank owns 100% of the ordinary share capital and voting rights of Coutts & Company Investment Management Limited, 440 Strand, London, WC2R 0QS, which is an unlisted company incorporated in Great Britain and registered in England and Wales. Coutts & Company Investment Management Ltd became dormant during 2007 and will be wound up in 2013.

Other wholly-owned subsidiary undertakings are unlisted dormant companies used mainly for nominee purposes, all of which are incorporated in Great Britain and registered in England and Wales.

**13. Intangible assets**

	<b>Group and Bank</b>
	<b>Software</b>
	<b>Development</b>
	<b>Costs</b>
	<b>£'000</b>
<b>2012</b>	
Cost:	
At 1 January 2012	<b>17,299</b>
Additions	<b>8,812</b>
At 31 December 2012	<b>26,111</b>
Amortisation:	
At 1 January 2012	<b>-</b>
Charge for the year	<b>1,632</b>
At 31 December 2012	<b>1,632</b>
<b>Net book value</b>	
At 31 December 2012	<b>24,479</b>
	<b>Group and Bank</b>
	<b>Software</b>
	<b>Development</b>
	<b>Costs</b>
	<b>£'000</b>
<b>2011</b>	
Cost:	
At 1 January 2011	<b>4,757</b>
Additions	<b>12,542</b>
At 31 December 2011	<b>17,299</b>
Amortisation:	
At 1 January and 31 December 2011	<b>-</b>
<b>Net book value</b>	
At 31 December 2011	<b>17,299</b>

The amortisation period for software development costs incurred on Coutts & Company Avaloq development is 8 years.



**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**14. Property, plant and equipment**

	Group and Bank			Total £'000
	Long leasehold £'000	Short leasehold £'000	Computers and other equipment £'000	
<b>2012</b>				
Cost:				
At 1 January 2012	5,716	13,372	21,425	40,513
Additions	237	1,746	645	2,628
Disposals	-	(3,702)	(2,453)	(6,155)
At 31 December 2012	<b>5,953</b>	<b>11,416</b>	<b>19,617</b>	<b>36,986</b>
Accumulated depreciation and amortisation:				
At 1 January 2012	2,151	8,905	18,885	29,941
Charge for the year	202	706	424	1,332
Disposals	-	(1,600)	(2,083)	(3,683)
At 31 December 2012	<b>2,353</b>	<b>8,011</b>	<b>17,226</b>	<b>27,590</b>
<b>Carrying amount at 31 December 2012</b>	<b>3,600</b>	<b>3,405</b>	<b>2,391</b>	<b>9,396</b>

	Group and Bank			Total £'000
	Long leasehold £'000	Short leasehold £'000	Computers and other equipment £'000	
<b>2011</b>				
Cost:				
At 1 January 2011	5,684	13,027	21,718	40,429
Additions	32	2,200	658	2,890
Disposals	-	(1,855)	(951)	(2,806)
At 31 December 2011	<b>5,716</b>	<b>13,372</b>	<b>21,425</b>	<b>40,513</b>
Accumulated depreciation and amortisation:				
At 1 January 2011	2,012	9,686	19,227	30,925
Charge for the year	139	1,005	587	1,731
Disposals	-	(1,786)	(929)	(2,715)
At 31 December 2011	<b>2,151</b>	<b>8,905</b>	<b>18,885</b>	<b>29,941</b>
<b>Carrying amount at 31 December 2011</b>	<b>3,565</b>	<b>4,467</b>	<b>2,540</b>	<b>10,572</b>

**15. Derivatives**

	Group and Bank					
	2012			2011		
	Notional amounts £'000	Assets £'000	Liabilities £'000	Notional amounts £'000	Assets £'000	Liabilities £'000
<b>Exchange rate related contracts</b>						
Forward foreign exchange	166,318	1,368	1,263	268,690	2,855	2,554
<b>Free standing derivatives</b>						
Interest rate related contracts:						
Futures, forwards and options	1,288,526	42,333	42,333	1,281,758	45,513	45,513
	<b>1,454,844</b>	<b>43,701</b>	<b>43,596</b>	<b>1,550,448</b>	<b>48,368</b>	<b>48,067</b>

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**16. Prepayments, accrued income and other assets**

	Group		Bank	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Deferred taxation (Note 18)	7,473	6,793	7,485	6,811
Corporation tax	-	18,493	-	18,493
Other assets, prepayments and accrued income				
- RBS Group undertakings	29,032	14,298	29,032	14,298
- other	30,194	29,957	29,382	28,184
	<b>66,699</b>	<b>69,541</b>	<b>65,899</b>	<b>67,786</b>

**17. Accruals, deferred income and other liabilities**

	Group		Bank	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Taxation	34,161	19,162	14,124	-
Payables and accrued expenses:				
- RBS Group undertakings	60,646	37,191	60,646	37,191
Other accruals and deferred income:	163,388	161,220	147,510	147,859
	<b>258,195</b>	<b>217,573</b>	<b>222,280</b>	<b>185,050</b>

**18. Deferred tax**

	Group			Bank		
	Accelerated capital allowances £'000	Other timing differences £'000	Total £'000	Accelerated capital allowances £'000	Other timing differences £'000	Total £'000
At 1 January 2011	(2,035)	(4,749)	(6,784)	(2,035)	(4,773)	(6,808)
Charge to income statement	680	(689)	(9)	680	(683)	(3)
At 1 January 2012	(1,355)	(5,438)	(6,793)	(1,355)	(5,456)	(6,811)
Charge to income statement	420	(1,100)	(680)	420	(1,094)	(674)
At 31 December 2012	<b>(935)</b>	<b>(6,538)</b>	<b>(7,473)</b>	<b>(935)</b>	<b>(6,550)</b>	<b>(7,485)</b>

The provision for UK deferred taxation has been calculated at 23% (2011: 25%), being the latest enacted rate of corporation tax. A deferred tax asset of £7,473k has been recognised for the Group at 31 December 2012 (2011: £6,793k). This asset has been recognised in the financial statements following the deferral of bonuses under the medium-term incentive plan, the provision for litigation and sundry losses, the impairment provision and accelerated capital allowances. The directors are of the opinion, based on recent and forecasted trading, that the tax due on future profits in the current and next financial year will exceed the value of the deferred tax asset.

The directors are of the opinion that, in view of the type and use of properties involved, the likelihood of any material tax liabilities arising on the disposal of the Group's properties at current market value is so remote that no useful purpose would be served in attempting to quantify it. Most of the Group's properties are occupied for the purposes of the Group's trade and consequently any gains arising on disposal are normally rolled-over pursuant to Taxation of Chargeable Gains Act 1992, Section 152.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**19. Provisions for liabilities and charges**

	Group and Bank		
	Provision for severance <sup>(1)</sup> £'000	Other provisions <sup>(2)</sup> £'000	Total provisions £'000
At 1 January 2012	5,918	798	6,716
Charged to the profit and loss	12,275	5,000	17,275
Released during the year	-	(200)	(200)
Utilised in year	(15,683)	-	(15,683)
At 31 December 2012	2,510	5,598	8,108

(1) The Group provides for future severance costs where there is a constructive obligation arising within the next 12 months.

(2) Other provisions arise in the normal course of business and are expected to crystallise in the foreseeable future.

**20. Subordinated liabilities**

	Group and Bank			
	2012 Interest rate	2012 £'000	2011 Interest rate	2011 £'000
Primary Capital Floating Rate Stock, due to National Westminster Bank Plc				
£13,300,000 (1)	0.79%	13,300	1.48%	13,300
US\$15,000,000 (2)	0.65%	9,338	0.87%	9,693
£10,000,000 (3)	1.02%	10,000	1.58%	10,000
		32,638		32,993
Primary Capital Floating Rate Stock, due to Royal Bank of Scotland Plc				
£30,000,000 (4)	1.58%	30,000	1.95%	30,000
€20,000,000 (5)	1.22%	16,304	2.55%	16,729
		46,304		46,729
		78,942		79,722

(1) This stock, issued in 1987 to the National Westminster Bank Plc, has no final maturity, but all or part of it may be redeemed by Coutts & Company at any time, subject to the prior consent of the Financial Services Authority.

(2) This stock, issued in 1988 to the National Westminster Bank Plc, has no final maturity, but all or part of it may be redeemed by Coutts & Company at any time, subject to the prior consent of the Financial Services Authority.

(3) This stock, issued in 2002 to the National Westminster Bank Plc, has a final maturity date of December 2017.

(4) This stock, issued in 2008 to The Royal Bank of Scotland plc, has a final maturity date of January 2023.

(5) This stock, issued in 2008 to The Royal Bank of Scotland plc, has a final maturity date of January 2023.

These primary loan stock capital issues by the Bank are unsecured and are subordinated to the claims of senior creditors. The primary loan capital is available to absorb losses but ranks ahead of other existing capital in the event of liquidation.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**21. Share capital**

	Group and Bank			
	Allotted, called up and fully paid		Authorised	
	31 December 2012	31 December 2011	2012	2011
	£'000	£'000	£'000	£'000
<i>Equity Shares:</i>				
Ordinary shares of £1	41,333	41,333	41,333	41,333
Total share capital	41,333	41,333	41,333	41,333

Number of shares	Allotted, called up and fully paid		Authorised	
	2012		2012	
	Thousands		Thousands	
	Thousands		Thousands	
<i>Equity shares:</i>				
Ordinary shares of £1	41,333	41,333	41,333	41,333

**22. Risk management**

The major risks associated with the Group's businesses are market, liquidity, credit, regulatory and operational risk. The Group has established a comprehensive framework for managing these risks which is continually evolving as the Group's business activities change in response to market, credit, product and other developments.

The Group has established clear risk policies, including limits, reporting lines and control procedures. This framework is designed to provide tight control and is reviewed regularly by both Executive and Board Committees.

**Market risk**

Market risk is the risk that changes in interest rates, foreign exchange rates, prices, volatilities and correlations may have an adverse financial impact on the Group's financial condition or results.

The Group does not maintain any material proprietary trading positions and consequently has limited exposure to market risk. The market risk that arises through the provision of products and services to customers, being principally interest rate and foreign exchange risk, is predominantly hedged. Unhedged market risk is small in accordance with policy limits.

The Group does not maintain material open currency positions.

At the RBS Group level, the risk appetite is expressed in the form of a combination of Value at Risk ('VaR'), sensitivity and scenario limits. VaR is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the RBS Group's VaR assumes a time horizon of one trading day and confidence level of 99% as it is considered that this provides greater clarity in respect of more severe potential economic outcomes. The RBS Group's VaR model is based on a historical simulation model utilising data from the previous two years trading results. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by relevance of the historical data used. The RBS Group's method, however, does not make any assumption about the nature or type of underlying loss distribution.

The RBS Group's VaR should be interpreted in light of the limitations of the methodology used, as follows:

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the time series horizon. Therefore, events that are more severe than those in the historical data series cannot be predicted.
- The use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.
- The RBS Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intra-day profit and losses will be incurred.

These limitations mean that the RBS Group cannot guarantee that losses will not exceed the VaR.

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

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Market risk (continued)****Foreign currency risk**

The Group does not maintain material non-trading open currency positions.

The Group does not maintain any material proprietary trading positions and consequently has limited exposure to foreign exchange movements. The foreign exchange risk is predominantly hedged.

**Interest rate risk**

Interest rate risk arises where assets and liabilities have different re-pricing dates. Group policy requires all interest risk to be transferred to trading units either within the RBS Group or with third parties, through arm's length cash transactions and derivatives, principally interest rate swaps.

The directors consider that the Group and Bank are not materially exposed to adverse profit and loss impact from interest rate volatility as no material proprietary interest rate positions are held.

**Liquidity risk**

The Group has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Group manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities with no material liquidity gaps.

The contractual maturity of assets and liabilities, shown in the following tables, highlight the maturity transformation which underpins the role of banks to lend longer-term but funded predominantly by short-term liabilities such as customer deposits. In practice, the behaviour profile of many assets and liabilities exhibit greater stability and longer maturity than the contractual maturity.

The table below analyses the contractual undiscounted cash flows receivable and payable up to a period of twenty years including future receipts and payments of interest by contractual maturity.

	Group					
	0 - 3 Months £ '000	3 - 12 Months £ '000	1 - 3 Years £ '000	3 - 5 Years £ '000	5 - 10 Years £ '000	10 - 20 Years £ '000
<b>2012</b>						
<b>Assets by contractual maturity</b>						
Cash and cash equivalents	3,572	-	-	-	-	-
Loans and advances to banks	8,282,622	2,381,133	2,465,324	1,232,662	23,194	-
Total maturing assets	8,286,194	2,381,133	2,465,324	1,232,662	23,194	-
Loans and advances to customers	3,057,582	1,167,088	2,290,798	2,098,697	875,359	917,235
<b>Total assets</b>	<b>11,343,776</b>	<b>3,548,221</b>	<b>4,756,122</b>	<b>3,331,359</b>	<b>898,553</b>	<b>917,235</b>
<b>Liabilities by contractual maturity</b>						
Deposits by banks	1,650,304	744,008	583,252	291,626	9,322	-
Subordinated liabilities	78,942	-	-	-	-	-
Total maturing liabilities	1,729,246	744,008	583,252	291,626	9,322	-
Customer accounts	18,460,370	1,217,249	661,964	197,454	23,195	-
<b>Total liabilities</b>	<b>20,189,616</b>	<b>1,961,257</b>	<b>1,245,216</b>	<b>489,080</b>	<b>32,517</b>	<b>-</b>
Maturity gap	(8,845,840)	1,586,964	3,510,906	2,842,279	866,036	917,235
Cumulative maturity gap	(8,845,840)	(7,258,876)	(3,747,970)	(905,691)	(39,655)	877,580
<b>Guarantees and commitments – notional amount</b>						
Guarantees (1)	524,026	-	-	-	-	-
Commitments (2)	3,189,086	-	-	-	-	-
	<b>3,713,112</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.

(2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Liquidity risk (continued)**

	Group					
	0 - 3 Months £ '000	3 - 12 Months £ '000	1 - 3 Years £ '000	3 - 5 Years £ '000	5 - 10 Years £ '000	10 - 20 Years £ '000
<b>2011*</b>						
<b>Assets by contractual maturity</b>						
Cash and cash equivalents	2,690	-	-	-	-	-
Loans and advances to banks	7,725,393	2,160,609	1,767,189	1,185,050	-	-
Total maturing assets	7,728,083	2,160,609	1,767,189	1,185,050	-	-
Loans and advances to customers	4,294,069	947,381	1,598,079	1,929,440	1,167,985	347,597
<b>Total assets</b>	<b>12,022,152</b>	<b>3,107,990</b>	<b>3,365,268</b>	<b>3,114,490</b>	<b>1,167,985</b>	<b>347,597</b>
<b>Liabilities by contractual maturity</b>						
Deposits by banks	738,457	674,253	531,211	191,980	11,880	-
Subordinated liabilities	79,722	-	-	-	-	-
Total maturing liabilities	818,179	674,253	531,211	191,980	11,880	-
Customer accounts	17,552,360	1,470,435	462,501	462,501	-	-
<b>Total liabilities</b>	<b>18,370,539</b>	<b>2,144,688</b>	<b>993,712</b>	<b>654,481</b>	<b>11,880</b>	<b>-</b>
Maturity gap	(6,348,387)	963,302	2,371,556	2,460,009	1,156,105	347,597
Cumulative maturity gap	(6,348,387)	(5,385,085)	(3,013,529)	(553,520)	602,585	950,182
<b>Guarantees and commitments – notional amount</b>						
Guarantees (1)	633,454	-	-	-	-	-
Commitments (2)	3,361,214	-	-	-	-	-
	<b>3,994,668</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

\* Numbers represented from prior year balance(s)

(1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.

(2) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

	Bank					
	0 - 3 Months £ '000	3 - 12 Months £ '000	1 - 3 Years £ '000	3 - 5 Years £ '000	5 - 10 Years £ '000	10 - 20 Years £ '000
<b>2012</b>						
<b>Assets by contractual maturity</b>						
Cash and cash equivalents	3,472	-	-	-	-	-
Loans and advances to banks	8,287,966	2,381,133	2,465,324	1,232,662	23,194	-
Total maturing assets	8,291,438	2,381,133	2,465,324	1,232,662	23,194	-
Loans and advances to customers	6,191,249	843,995	1,452,809	1,139,727	422,073	225,794
<b>Total assets</b>	<b>14,482,687</b>	<b>3,225,128</b>	<b>3,918,133</b>	<b>2,372,389</b>	<b>445,267</b>	<b>225,794</b>
<b>Liabilities by contractual maturity</b>						
Deposits by banks	1,669,581	744,008	583,252	291,626	9,322	-
Subordinated liabilities	78,942	-	-	-	-	-
Total maturing liabilities	1,748,523	744,008	583,252	291,626	9,322	-
Customer accounts	18,460,370	1,217,249	661,964	197,454	23,195	-
<b>Total liabilities</b>	<b>20,208,893</b>	<b>1,961,257</b>	<b>1,245,216</b>	<b>489,080</b>	<b>32,517</b>	<b>-</b>
Maturity gap	(5,726,206)	1,263,871	2,672,917	1,883,309	412,750	225,794
Cumulative maturity gap	(5,726,206)	(4,462,335)	(1,789,418)	93,891	506,641	732,435
<b>Guarantees and commitments – notional amount</b>						
Guarantees (1)	524,026	-	-	-	-	-
Commitments (2)	2,967,001	-	-	-	-	-
	<b>3,491,027</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.

(2) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Liquidity risk (continued)**

	Bank					
	0 - 3 Months	3 - 12 Months	1 - 3 Years	3 - 5 Years	5 - 10 Years	10 - 20 Years
2011*	£ '000	£ '000	£ '000	£ '000	£ '000	£ '000
<b>Assets by contractual maturity</b>						
Cash and cash equivalents	2,590	-	-	-	-	-
Loans and advances to banks	7,727,820	2,160,609	1,767,189	1,185,050	-	-
Total maturing assets	7,730,410	2,160,609	1,767,189	1,185,050	-	-
Loans and advances to customers	7,308,354	813,327	807,240	535,335	664,851	-
<b>Total assets</b>	<b>15,038,764</b>	<b>2,973,936</b>	<b>2,574,429</b>	<b>1,720,385</b>	<b>664,851</b>	<b>-</b>
<b>Liabilities by contractual maturity</b>						
Deposits by banks	738,995	674,253	531,211	191,980	11,880	-
Subordinated liabilities	79,722	-	-	-	-	-
Total maturing liabilities	818,717	674,253	531,211	191,980	11,880	-
Customer accounts	17,552,360	1,470,435	462,501	462,501	-	-
<b>Total liabilities</b>	<b>18,371,077</b>	<b>2,144,688</b>	<b>993,712</b>	<b>654,481</b>	<b>11,880</b>	<b>-</b>
Maturity gap	(3,332,313)	829,248	1,580,717	1,065,904	652,971	-
Cumulative maturity gap	(3,332,313)	(2,503,065)	(922,348)	143,556	796,527	796,527
<b>Guarantees and commitments – notional amount</b>						
Guarantees (1)	633,454	-	-	-	-	-
Commitments (2)	3,121,590	-	-	-	-	-
	<b>3,755,044</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

\* Numbers represented from prior year balance(s)

(1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.

(2) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

Financial assets have been reflected in the time band of the latest date on which they could be repaid unless earlier repayment can be demanded by the reporting entity; financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty.

If the repayment of a financial asset or liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the asset is included in the latest date on which it can repay regardless of early repayment whereas the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. The settlement date of debt securities in issue issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date. As the repayment of assets and liabilities are linked, the repayment of assets in securitisations are shown on the earliest date that the asset can be prepaid as this is the basis used for liabilities.

The principal amounts of financial assets and liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table as are interest payments after 20 years.

**NOTES TO THE FINANCIAL STATEMENTS** *for the year ended 31 December 2012***22. Risk management (continued)****Credit risk**

Credit risk is the risk of financial loss owing to the failure of customers or counterparties to meet their obligations to the Group. The quantum and nature of credit risk assumed in the Group's different business activities vary considerably, while the overall credit risk outcome usually exhibits a degree of correlation to the macroeconomic environment.

**Credit risk organisation**

The existence of a strong credit risk management organisation is vital to support the goals of the Group. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and a focus on the importance of sustainable lending practices. The role of the credit risk management organisation is to provide the business with the support necessary to develop and maintain a sound lending franchise within risk appetite while providing strong independent oversight and challenge.

Responsibility for development of RBS Group-wide policies, credit risk frameworks, Group-wide portfolio management and assessment of provision adequacy sits within the functional Group Credit Risk Organisation (GCR) within the RBS Group under the management of the Group Chief Credit Officer. The Bank and Group work together with GCR to ensure that the Board's expressed risk appetite is met within a clearly defined and managed control environment. Activities within credit risk include credit approval, transaction and portfolio analysis, early problem recognition and setting standards for ongoing credit risk stewardship within the business areas.

**Credit risk mitigation**

The Group employs a number of structures and techniques to mitigate credit risk. Unsecured facilities are carefully considered as to affordability and repayment and generally represent only the lower value exposures within the Group's books. A large part of the Group's credit exposures are covered by security that is assigned a value below the assessed market value in accordance with stated credit policies. These include a range of transactions, from retail mortgage lending to commercial financing, with a security interest in a physical or financial asset.

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

**Provision analysis**

Early and active management of problem exposures ensures that credit losses are minimised. Specialised units are used to ensure that appropriate action to mitigate risk is taken in a timely manner.

Portfolio provisions are reassessed regularly as part of the Group's ongoing monitoring process.



**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Credit risk (continued)**

Credit risk assets consist of loans and advances (including overdraft facilities), guarantees issued on behalf of clients and financial instruments (measured at mark to market value) across all customer types. Where relevant, and unless otherwise stated, data reflects the effect of credit mitigation techniques.

**Credit risk asset quality**

The Group has made the decision to adopt the standardised approach to credit capital calculations. Under the standardised approach there is no requirement for probability of default to be calculated. Due to this decision, the assets lent do not have a probability of default rating and have been classified into asset quality bands based on a set of assessment criteria and the expert judgement of credit professionals.

Asset Quality Grade	Minimum	Maximum
AQ1	0.00	0.2
AQ2	0.2	0.6
AQ3	0.6	1.5
AQ4	1.5	5.0
AQ5	5.0	-

Larger commercial clients are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades map to both an RBS Group level asset quality scale (illustrated above), used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios.

The following table provides an analysis of the credit quality of third party financial assets by asset quality grade.

	Group					
	Cash and cash equivalents	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£ '000	£ '000	£ '000	£ '000	£ '000	£ '000
<b>2012</b>						
AQ1	3,572	14,381,719	6,882,237	43,096	2,088,865	371,913
AQ2	-	3,101	1,889,643	111	532,134	94,351
AQ3	-	-	888,685	50	314,429	49,885
AQ4	-	115	3,398	71	229,237	43,540
AQ5	-	-	618,504	373	25,312	4,476
Accruing past due	-	-	31,641	-	-	-
Non accrual	-	-	143,087	-	-	-
Less Impairment Provision	-	-	(50,436)	-	-	-
<b>Total</b>	<b>3,572</b>	<b>14,384,935</b>	<b>10,406,759</b>	<b>43,701</b>	<b>3,190,146</b>	<b>564,165</b>

	Group					
	Cash and cash equivalents	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£ '000	£ '000	£ '000	£ '000	£ '000	£ '000
<b>2011</b>						
AQ1	2,690	12,837,873	6,464,292	48,368	2,184,746	436,553
AQ2	-	368	1,666,536	-	556,726	110,751
AQ3	-	-	1,395,080	-	330,072	58,555
AQ4	-	-	515,418	-	239,283	51,107
AQ5	-	-	140,511	-	51,499	10,482
Accruing past due	-	-	78,831	-	-	-
Non accrual	-	1,524	59,166	-	-	-
Less Impairment Provision	-	(1,524)	(35,283)	-	-	-
<b>Total</b>	<b>2,690</b>	<b>12,838,241</b>	<b>10,284,551</b>	<b>48,368</b>	<b>3,362,326</b>	<b>667,448</b>

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Credit risk (continued)**

	Bank					
	Cash and cash equivalents	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£ '000	£ '000	£ '000	£ '000	£ '000	£ '000
<b>2012</b>						
AQ1	3,472	14,389,511	8,417,588	43,096	1,956,738	371,913
AQ2	-	768	740,961	111	496,411	94,351
AQ3	-	-	467,403	50	262,457	49,885
AQ4	-	-	-	71	229,079	43,540
AQ5	-	-	572,890	373	23,544	4,476
Accruing past due	-	-	12,965	-	-	-
Non accrual	-	-	111,707	-	-	-
Less Impairment Provision	-	-	(47,867)	-	-	-
<b>Total</b>	<b>3,472</b>	<b>14,390,279</b>	<b>10,275,647</b>	<b>43,701</b>	<b>2,968,229</b>	<b>564,165</b>

	Bank					
	Cash and cash equivalents	Loans and advances to banks	Loans and advances to customers	Derivatives	Commitments	Contingent liabilities
	£ '000	£ '000	£ '000	£ '000	£ '000	£ '000
<b>2011</b>						
AQ1	2,590	12,840,300	7,731,434	48,368	2,042,440	436,553
AQ2	-	368	1,111,579	-	518,152	110,751
AQ3	-	-	587,704	-	273,953	58,555
AQ4	-	-	512,962	-	239,112	51,107
AQ5	-	-	105,217	-	49,045	10,482
Accruing past due	-	-	60,487	-	-	-
Non accrual	-	1,524	53,642	-	-	-
Less Impairment Provision	-	(1,524)	(33,918)	-	-	-
<b>Total</b>	<b>2,590</b>	<b>12,840,668</b>	<b>10,129,107</b>	<b>48,368</b>	<b>3,122,702</b>	<b>667,448</b>

**Collateral and other credit enhancements received**

Within its secured portfolios, the Group has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to the Group arising from the failure of a customer or counterparty to meet their obligations. These include: cash deposits; charges over residential and commercial property, debt securities, equity shares and other financial collateral; and third-party guarantees. The existence of collateral may affect the pricing of a facility and its regulatory capital requirement. When a collateralised financial asset becomes impaired, the impairment charge directly reflects the realisable value of collateral and any other credit enhancements.

**Corporate exposures**

The type of collateral taken by the Group's commercial businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- **Physical assets:** These include business assets such as stock, plant and machinery and vehicles. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.
- **Real estate:** The Group takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically be at a discount to the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer.
- **Receivables:** When taking a charge over receivables, the Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.
- **Other assets:** When taking a mortgage debenture, the Bank can capture intangible asset values such as the future value of cashflow arising from the collection of intellectual property rights, royalties, licence fees, debtors etc.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Credit risk (continued)**

The security charges may be floating or fixed, with the type of security likely to impact (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

The Group does not recognise certain asset classes as collateral: for example, short-leasehold property and equity shares of the borrowing company. Collateral with value that is correlated to the status of the obligor is assessed on a case-by-case basis and, where necessary, over-collateralisation may be required.

The Group uses industry-standard loan and security documentation wherever possible. Non-standard documentation is typically prepared by external lawyers on a case-by-case basis. The Group's business and credit teams are supported by an in-house specialist legal team.

The existence of collateral has an impact on provisioning. Where the Group no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net present value of the realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

	2012	
	Performing £ '000	Non-performing £ '000
<b>Commercial real estate by average loan to value (LTV)</b>		
<70%	1,212,848	6,195
>70% and ≤90%	66,900	664
>90% and ≤110%	18,140	6,976
>110% and ≤130%	7,417	2,969
>130%	-	7,513
Total with LTVs	1,305,305	24,317
Unsecured	-	-
Total book	1,305,305	24,317
Total portfolio weighted average LTV	52.1%	75.0%

	2012		2011	
	Loans	Provisions	Loans	Provisions
<b>Non-performing corporate loans (excluding commercial real estate)</b>	£ '000	£ '000	£ '000	£ '000
Secured	15,590	6,465	6,707	1,213
Unsecured	3,504	3,504	-	-

**Retail exposures**

All borrowing applications, whether secured or not, are subject to appropriate credit risk underwriting processes including an assessment of affordability and the source of repayment. Pricing is typically higher on unsecured than secured loans. For secured loans, pricing will typically vary by LTV: higher-LTV products are typically subject to higher interest rates commensurate with the associated risk.

The value of a property intended to secure a mortgage is assessed during the loan underwriting process using industry-standard methodologies. Property values supporting home equity lending reflect individual appraisal valuations unless the lending value is very low.

The existence of collateral has an impact on provisioning levels. Once a secured loan is classified as non-performing, the realisable net present value of the underlying collateral allowing for the costs associated with repossession are used to estimate the provision required.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Credit risk (continued)**

The tables below shows period-end LTVs for the Group's residential mortgage portfolio split between performing and non-performing.

	2012 £'000	2011 £'000
<b>Non-performing residential mortgages by average loan to value (LTV)</b>		
<70%	3,528	1,426
>70% and <=90%	6,426	3,132
>90% and <=110%	853	-
>110% and <=130%	2,578	-
>130%	-	965
<b>Total</b>	<b>13,385</b>	<b>5,523</b>

<b>Total portfolio average by LTV</b>	<b>65.6%</b>	<b>60.1%</b>
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	2012 £'000	2011 £'000
<b>Performing residential mortgages by average loan to value (LTV)</b>		
<70%	3,657,785	2,812,570
>70% and <=90%	378,346	820,508
>90% and <=110%	9,994	12,499
>110% and <=130%	232	-
>130%	15,346	-
<b>Total</b>	<b>4,061,703</b>	<b>3,645,577</b>

<b>Total portfolio average by LTV</b>	<b>26.1%</b>	<b>43.3%</b>
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Aside from the lending portfolios, the Group receives collateral and other credit enhancements on other financial assets on its balance sheet as detailed in the following table:

	2012 £'000	2011 £'000
<b>Derivative assets gross exposure</b>	<b>43,701</b>	<b>48,368</b>

**Regulatory risk**

The Group manages regulatory risk under the 'Three Lines of Defence' model in line with the RBS Group. This model defines responsibilities and accountabilities in accordance with the following principles:

- the business units (including business areas and support functions) are the first 'Line of Defence'. They are accountable for owning and managing, within a defined risk appetite, the risks which exist in their business area;
- independent monitoring and control functions are the second 'Line of Defence'. They are accountable for owning and developing the risk and control frameworks and tools which the business uses to discharge its responsibilities; and
- Group Internal Audit is the third Line of Defence and provides independent assurance over the key risks to the organisation, which includes an assessment of the entire control framework.

Compliance within the Group operates under these principles as a second line of defence since reporting lines are to the RBS Group function rather than at a divisional level.

Following the imposition of financial penalties by the FSA in 2011 and 2012, the Group has invested significantly in its business risk functions, the first line of defence, and has also made substantial investment in infrastructure, processes and training beyond regulatory requirements, as part of its preparations for the introduction of the FSA's Retail Distribution Review. In response to changes in the regulatory environment in which the division operates, compliance within the Group is moving towards a revised target operating model, which is expected to be in place by end 2013.

**Reputational risk**

Currently the Group manages reputational risk through a number of functions, such as the Communications & Corporate Services division. At the RBS Group level there is a Group Sustainability management function and also an Environmental, Social and Ethical (ESE) Risk management function. This latter function is responsible for assessing ESE risks associated with business engagements and divisions. The risk is viewed as material given the key nature of the Group's market reputation in achieving its strategic risk objectives.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**22. Risk management (continued)****Anti-Money Laundering**

The Group is part of an RBS Group-wide Anti Money Laundering (AML) Change Programme that is strengthening anti-money laundering systems and controls by delivering:

- Client Onboarding & Ongoing Reviews: Robust onboarding processes that record a client's risk and key data requirements under the policy. Reviews are carried out on an ongoing basis as well as being driven by one-off events thus ensuring the client continues to meet the policy requirements.
- Remediation: Remediation of client files to ensure full understanding of information requirements demanded
- Target Operating Model: Delivery of target architecture within the Wealth division and alignment to the RBS Group Operating Model standards that will strengthen the RBS Group's management of AML risks

A considerable investment has been made in 2012 to bring the business closer to this target state. Work will continue in 2013 with significant resources, in both personnel and financial terms, being dedicated to the ongoing, three-year programme of work.

**Operational risk**

Operational risks are inherent in the Group's business. Operational risk losses occur as the result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour or from external events. The key mitigating processes and controls include risk and control assessment, scenario analysis, loss data collection, new product approval process, key risk indicators, notifiable events process and the self certification process. The implementation of these processes and controls is facilitated and overseen by operational risk teams, with internal audit providing independent evaluation of the control framework.

**23. Capital resources**

The following table analyses the Group's regulatory capital resources at 31 December:

	<b>Group</b>	
	<b>2012</b>	<b>2011</b>
	<b>Total</b>	<b>Total</b>
	<b>£'000</b>	<b>£'000</b>
<b>Composition of regulatory capital</b>		
Tier 1:		
Ordinary Shareholders' equity	41,333	41,333
Profit and Loss Account and other reserves	670,633	782,283
<b>Core Tier 1 capital</b>	<b>711,966</b>	<b>823,616</b>
Deductions:		
Software Development Costs	(24,479)	(17,299)
Other adjustments for regulatory purposes	(88,438)	(112,241)
<b>Total tier 1 capital</b>	<b>599,049</b>	<b>694,076</b>
Tier 2:		
Perpetual subordinated debt	22,580	22,993
Term subordinated debt	56,362	56,729
Collective impairment allowances	6,147	4,027
<b>Total tier 2 capital</b>	<b>85,089</b>	<b>83,749</b>
<b>Other Deductions:</b>		
Material holdings	(10)	(10)
<b>Total Regulatory capital</b>	<b>684,128</b>	<b>777,815</b>
<b>Risk Weighted assets</b>	<b>7,179,089</b>	<b>7,980,570</b>

The Group manages its capital to ensure capital cover at least meets the RBS Group Risk Asset Ratio ("RAR") requirements. The capital structure of the Group consists of debt and equity attributable to equity holders comprising issued capital, reserves and retained earnings as disclosed in the Statement of Changes in Equity.

It is the Group's policy to maintain an appropriate capital base and to utilise it efficiently throughout its activities to optimise returns to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the FSA. The FSA uses RAR as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks). The Group has complied with FSA requirements during the year ended 31 December 2012.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**24. Memorandum items****Contingent liabilities and commitments**

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2012. Although the Group and Bank are exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group and Bank's expectation of future losses.

	<b>Group</b>		<b>Bank</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Contingent liabilities:</b>				
Guarantees and assets pledged as collateral security:				
Guarantees and irrevocable letters of credit	<b>524,026</b>	633,454	<b>524,026</b>	633,454
Other contingent liabilities	<b>40,139</b>	33,994	<b>40,139</b>	33,994
Total contingent liabilities	<b>564,165</b>	667,448	<b>564,165</b>	667,448
<b>Commitments:</b>				
Documentary credits and other short-term trade-related contingencies	<b>1,060</b>	1,112	<b>1,060</b>	1,112
Undrawn formal standby facilities, credit lines and other commitments to lend:				
1 year and over	<b>1,668,197</b>	750,215	<b>1,446,112</b>	510,591
Less than 1 year	<b>1,520,889</b>	2,610,999	<b>1,520,889</b>	2,610,999
Total commitments	<b>3,190,146</b>	3,362,326	<b>2,968,061</b>	3,122,702

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes and any potential loss is taken into account in assessing provisions for bad and doubtful debts in accordance with the Group's provisioning policy.

	<b>Group and Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
<b>Operating lease commitments:</b>		
At the year end, annual commitments under non-cancellable operating leases were:		
Premises – operating leases which expire:		
- within one year	<b>852</b>	978
- between one and five years	<b>2,218</b>	2,701
- in five years or more	<b>1,418</b>	2,020

The commitments under non-cancellable operating leases are paid annually as part of Coutts & Company management recharge to the RBS Group (Note 31).

Management and agency services: The Group provides investment management services. Funds under management at 31 December 2012 were £7,759m (2011: £7,398m).

Future contracted capital expenditure: The Group has contracted capital expenditure not provided for in the accounts of £5.3m (2011: £4.8m).

**Commitments**

Commitments to lend – under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments – these include forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**24. Memorandum items (continued)****Contingent liabilities**

Acceptances – in accepting a bill of exchange drawn on it by a customer a bank undertakes to pay the holder of the bill at maturity. Most acceptances are presented for payment and reimbursement by the customer is usually immediate. In the UK, bills accepted by certain banks designated by the Bank of England are eligible for rediscount at the Bank of England.

Endorsements – in endorsing a bill of exchange a bank accepts liability for payment of any shortfall on the bill at maturity. Unlike acceptances, the endorsing bank receives value for the bill, which is then rediscounted.

Guarantees – the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table on Memorandum Items on page 44. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities – these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material loss will arise from these transactions.

**Litigation**

As a participant in the financial services industry the Group operates in a highly regulated environment and is subject to significant legal and statutory risks. At any moment in time it is inevitable that the Group will be involved in a number of investigations and, or disputes. Such cases are subject to many uncertainties and their outcome is often difficult to predict, particularly in the early stages of a case. The directors of the Group have reviewed these actual, threatened and known potential claims and proceedings and, after consulting with the relevant legal advisers are satisfied that the outcome of these claims and proceedings will not have a material adverse effect on the Group's consolidated net assets, results of operations or cash flows.

**The Financial Services Compensation Scheme**

The Financial Services Compensation Scheme (FSCS), the UK's statutory fund of last resort for customers of authorised financial services firms, pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the industry. In relation to protected deposits, each deposit-taking institution contributes towards these levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year (which runs from 1 April to 31 March), subject to annual maxima set by the Financial Services Authority (FSA). In addition, the FSCS has the power to raise levies on a firm that has ceased to participate in the scheme and is in the process of ceasing to be authorised for the costs that it would have been liable to pay had the FSCS made a levy in the financial year it ceased to be a participant in the scheme.

The FSCS has borrowed from HM Treasury to fund compensation costs associated with Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The interest rate on these borrowings increased from 12 month LIBOR plus 30 basis points to 12 month LIBOR plus 100 basis points from April 2012. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS expects to levy the deposit taking sector for the balance of the principal on the non-Bradford & Bingley loans over three scheme years to repay the principal by March 2016 with a first instalment of £363 million in the 2013/14 scheme year.

The Group has accrued £3.3m for its share of estimated FSCS levies for the 2012/13 and 2013/14 scheme years.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**24. Memorandum items (continued)****Capital Support Deed**

The Bank, together with other members of the RBS Group, is party to a Capital Support Deed (CSD). Under the terms of the CSD, the Bank may be required, if compatible with its legal obligations, to make distributions on, or repurchase or redeem, its ordinary shares. The amount of this obligation is limited to the Bank's capital resources in excess of the capital and financial resources needed to meet its regulatory requirements. The Bank may also be obliged to make onward distribution to its ordinary shareholders of dividends or other capital distributions received from subsidiaries that are party to the CSD. The CSD also provides that, in certain circumstances, funding received by the Bank from other parties to the CSD becomes immediately repayable, such repayment being limited to the Bank's available resources.

**25. Net cash inflow/(outflow) from operating activities**

	<b>Group</b>		<b>Bank</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Operating profit	123,050	157,464	116,282	85,172
Losses on loans and advances written-off net of recoveries	14,865	9,685	13,447	9,421
Provisions for liabilities and charges	17,275	5,938	17,275	5,938
Equity dividends received	-	-	(75,000)	-
Depreciation and amortisation of tangible and intangible assets	2,964	1,731	2,964	1,731
Elimination of foreign exchange differences	208,097	202,569	208,097	202,566
Other non-cash items	(1,236)	(744)	(1,022)	(633)
Net cash inflows from trading activities	365,015	376,643	282,043	304,195
Increase in loans and advances to banks and customers	(1,594,327)	(2,757,710)	(1,620,372)	(2,683,266)
(Decrease)/Increase in derivatives	4,667	(18,569)	4,667	(18,569)
Increase in other assets, prepayments and accrued income	(14,971)	(6,913)	(15,932)	(8,114)
Changes in operating assets	(1,604,631)	(2,783,192)	(1,631,637)	(2,709,949)
Increase in deposits by banks and customers	1,743,166	1,282,212	1,761,905	1,280,992
(Decrease)/Increase in other liabilities, accruals and deferred income	9,740	11,935	7,223	(1,166)
(Decrease)/Increase in derivatives	(4,471)	18,679	(4,471)	18,679
Changes in operating liabilities	1,748,435	1,312,826	1,764,657	1,298,505
Taxes (paid)/received	(1,800)	(54,416)	16,956	(40,890)
Net cash inflow/(outflow) from operating activities	507,019	(1,148,139)	432,019	(1,148,139)

**26. Interest received and paid**

	<b>Group</b>		<b>Bank</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Interest received	638,990	533,169	553,882	463,653
Interest paid	(258,391)	(230,290)	(258,391)	(232,940)
	380,599	302,879	295,491	230,713

**27. Analysis of changes in financing during the year**

	<b>Group and Bank</b>	
	<b>2012</b>	<b>2011</b>
	<b>£'000</b>	<b>£'000</b>
Loan Capital:		
At 1 January	79,722	80,206
Currency translation	(780)	(484)
At 31 December (Note 20)	78,942	79,722



**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**28. Analysis of cash and cash equivalents**

	Group		Bank	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
At 1 January				
Cash	2,690	2,928	2,590	2,828
Cash equivalents	7,680,053	9,046,478	7,680,053	9,046,478
Net cash outflow	7,682,743	9,049,406	7,682,643	9,049,306
Effect of exchange rate changes on cash and cash equivalents	298,051	(1,163,480)	298,051	(1,163,480)
At 31 December	(208,965)	(203,183)	(208,965)	(203,183)
	7,771,829	7,682,743	7,771,729	7,682,643
Comprising:				
Cash and balances at central banks	3,572	2,690	3,472	2,590
Loans and advances to bank	7,768,257	7,680,053	7,768,257	7,680,053

**29. Segmental information**

The Group operates in the private banking sector, with 99% of business derived in the United Kingdom, and 1% of business derived in Monaco.

The directors consider private banking a single class of business.

**30. Transactions with directors**

As at 31 December 2012, the aggregate amounts outstanding in relation to the transactions, arrangements and agreements entered into by the Group in relation to loans to directors, including connected persons, or officers of the Bank is set out below:

	2012		2011	
	Aggregate amount outstanding £'000	Number of persons	Aggregate amount outstanding £'000	Number of persons
Directors:				
Loans	7,505	5	4,542	7
Officers:				
Loans	396	10	917	11

All of the above balances are classified under Loans and Advances to Customers.

**31. Related parties****UK Government**

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc. The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government. As a result, the UK Government and UK Government controlled bodies became related parties of the Bank.

Transactions between the company, the UK Government and UK Government controlled bodies, consisted solely of Corporation Tax and Value Added Tax.

**Group undertakings**

The Bank's ultimate holding company is The Royal Bank of Scotland Group plc, and its immediate parent company is The Royal Bank of Scotland plc. Both companies are incorporated in Great Britain and registered in Scotland.

As at 31 December 2012, The Royal Bank of Scotland Group plc heads the largest group in which the Bank is consolidated and National Westminster Bank plc heads the smallest group in which the company is consolidated. Copies of the consolidated accounts of both companies may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

**NOTES TO THE FINANCIAL STATEMENTS** for the year ended 31 December 2012**31. Related parties (continued)**

Revenue with other group companies in the period 1 January to 31 December 2012 comprised:

	£'000
Interest receivable	329,370
Interest payable	87,827
Fees and commissions receivable	15,198
Fees and commission payable	4,574

Other operating charges includes a management recharge of £92,390,781 (2011: £73,624,658) from The Royal Bank of Scotland Group plc. Included in the management recharge are the employee costs in respect of share-based payments and pension costs.

**32. Regulatory oversight**

As part of the RBS Group, the Group forms part of the RBS UK Defined Liquidity Group (DLG). This is a subset comprising the RBS Group's five main UK Banks, The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company plc. The FSA rules are focused on this group and cover adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment (ILAA) process. The ILAA informs the RBS Group board and FSA of the assessment and quantification of the DLG's liquidity risks and their mitigation. It also informs how much current and future liquidity is required.

**33. Post balance sheet events**

There have been no significant events between the year end and the date of approval of the financial statements which would require a change to, or disclosure in the financial statements.