

Pillar 3 Disclosure 2010

Pillar 3 Disclosure

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Pillar 3 Disclosure

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Forward-looking statements

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

Any forward-looking statements set out herein represent the Group's expectations or beliefs concerning future events and involve known and unknown risks and uncertainty that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. For example, certain of the market risk disclosures, some of which are only estimates and, therefore, could be

materially different from actual results, are dependent on key model characteristics and assumptions and are subject to various limitations. For further risks and uncertainties faced by the Group that may impact the statements set out in this document, please read its Annual Report and Accounts for the year ended 31 December 2010 and any other interim or update information published by the Group, including information furnished to the SEC on Form 6-K.

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

Basis of disclosure

The Pillar 3 disclosures being made by the Group are designed to comply with the FSA Handbook (BIPRU 11). They should be read in conjunction with the Group's 2010 Annual Report and Accounts, approved on 23 February 2011.

There are important differences between the accounting and Capital Requirements Directives (CRD) disclosures, which can be summarised as follows:

- The Basel II disclosures represent a regulatory, rather than an accounting basis of consolidation. Various businesses (for example insurance) are included in the latter, but not in the former. Therefore, these disclosures may not be comparable to other external disclosures made by the Group.
- The definition of exposure differs between Basel II and accounting. The Basel II definition used in the Pillar 3 disclosures is exposure at default (EAD) rather than the balance sheet or drawn balance plus mark-to-market, as used in the Group's 2010 Annual Report and Accounts.

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

The disclosures relate to the position through 2010, specifically the business at 31 December 2010. The comments relate to the business structure, governance and risk management approach at that date.

Comparatives have been shown for the year ended 31 December 2009 where appropriate. Certain disclosures have been revised to be consistent with 2010.

The information is not required to be and therefore has not been, subject to external audit.

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

Background

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

The framework is based around three Pillars:

- **Pillar 1 – Minimum capital requirements:** defines rules for the calculation of credit, market and operational risk;
- **Pillar 2 – Supervisory review process:** requires banks to undertake an Individual Capital Adequacy Assessment Process (ICAAP) for other risks; and
- **Pillar 3 – Market discipline:** requires expanded disclosures to allow investors and other market participants to understand the risk profiles of individual banks.

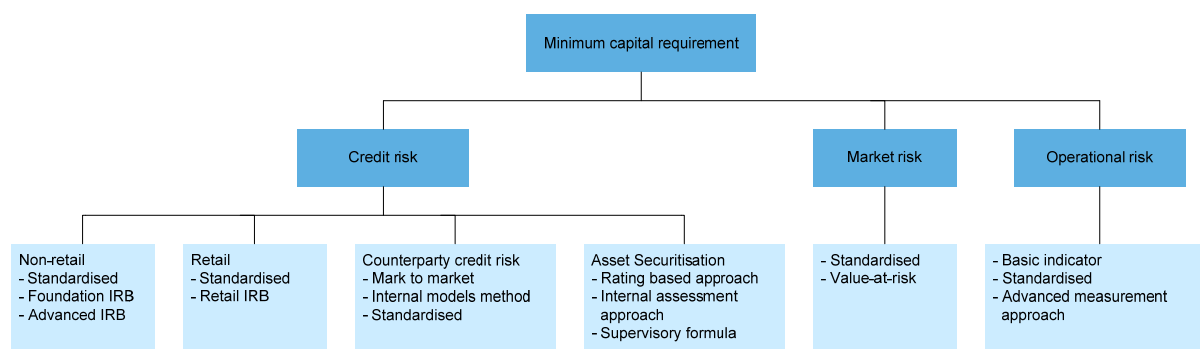
Banks are required to disclose all their material risks as part of the Pillar 3 framework. Some of these requirements have already been satisfied within the Group's 2010 Annual Report and Accounts, available on the Group's website. The 2010 Annual Report and Accounts include a range of Group and divisional risk factors and provides in-depth analysis on the specific risks to which the Group is exposed.

These Pillar 3 disclosures provide additional information over and above the Group's 2010 Annual Report and Accounts. Specifically, Pillar 3 provides additional information on the minimum capital requirements under Pillar 1. Liquidity risk, which does not form part of the minimum capital requirements, is discussed on pages 134 to 142 of the Group's 2010 Annual Report and Accounts. Disclosures on credit market activities are also published as part of the Group's 2010 Annual Report and Accounts on pages 204 to 220. Further information on regulatory developments, and in particular on the impact of Basel III and CRD IV is published on pages 131 to 133 of the Group's 2010 Annual Report and Accounts..

Pillar 1 – Minimum capital requirements

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

Chart 1: Minimum capital requirements structure



Application in the Group

For credit risk, the majority of the Group uses the advanced internal ratings based approach (advanced IRB) for calculating RWAs.

The Group manages market risk in the trading and non-trading (treasury) portfolios through the market risk management framework. The framework includes value-at-risk (VaR) limits, backtesting, stress testing, scenario analysis and position/sensitivity analysis.

For operational risk the Group uses The Standardised Approach (TSA) which calculates operational risk RWAs based on gross income. In line with other banks, the Group is considering adopting the Advanced Measurement Approach for all or part of the business.

Background continued

Pillar 2 – Supervisory review process

Pillar 2 focuses on risks either not adequately covered in, or excluded from, Pillar 1. The first part of Pillar 2 is the Group Board's assessment of capital requirements over the short and long-term (ICAAP).

The ICAAP is followed by in-depth discussions between the Group and regulators on the appropriate capital levels (this second stage is called the Supervisory Review and Evaluation Process or SREP).

For the Group, Pillar 2 currently focuses on pension risk and interest rate risk in the banking book (IRRBB), together with stress tests to assess the adequacy of capital across a range of economic scenarios and time periods. Whilst IRRBB forms part of these Pillar 3 disclosures, pension risk is discussed in the Group's 2010 Annual Report and Accounts on page 203.

Pillar 3 – Market discipline

The Group is committed to delivering best in class risk and capital disclosures, to ensure that stakeholders understand the risks inherent within the Group. The Pillar 3 disclosures are designed to encourage and promote market transparency and stability; it represents one component of the Group's broader disclosures.

Group Internal Audit undertook a review to assess the adequacy and effectiveness of the controls over the systems and processes to produce the Pillar 3 disclosures. The purpose of Group Internal Audit's review was to provide management with assurance over the Pillar 3 disclosure process controls to satisfy regulatory requirements and to prevent material misstatement.

The Group publishes its Pillar 3 disclosure on an annual basis, in line with the timescales required by the CRD.

The Group's various subsidiaries in Europe are responsible for publishing capital and RWA data externally through an appropriate mechanism (such as websites and annual reporting statements),

thereby satisfying the Committee of European Banking Supervisors requirements for member state disclosures. Outside the EU, local subsidiaries may make additional disclosures under Pillar 3, as required by their local regulators.

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

RBS N.V.

Pillar 3 is presented on a statutory basis and includes the capital and risk associated with RBS Holdings N.V..

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

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

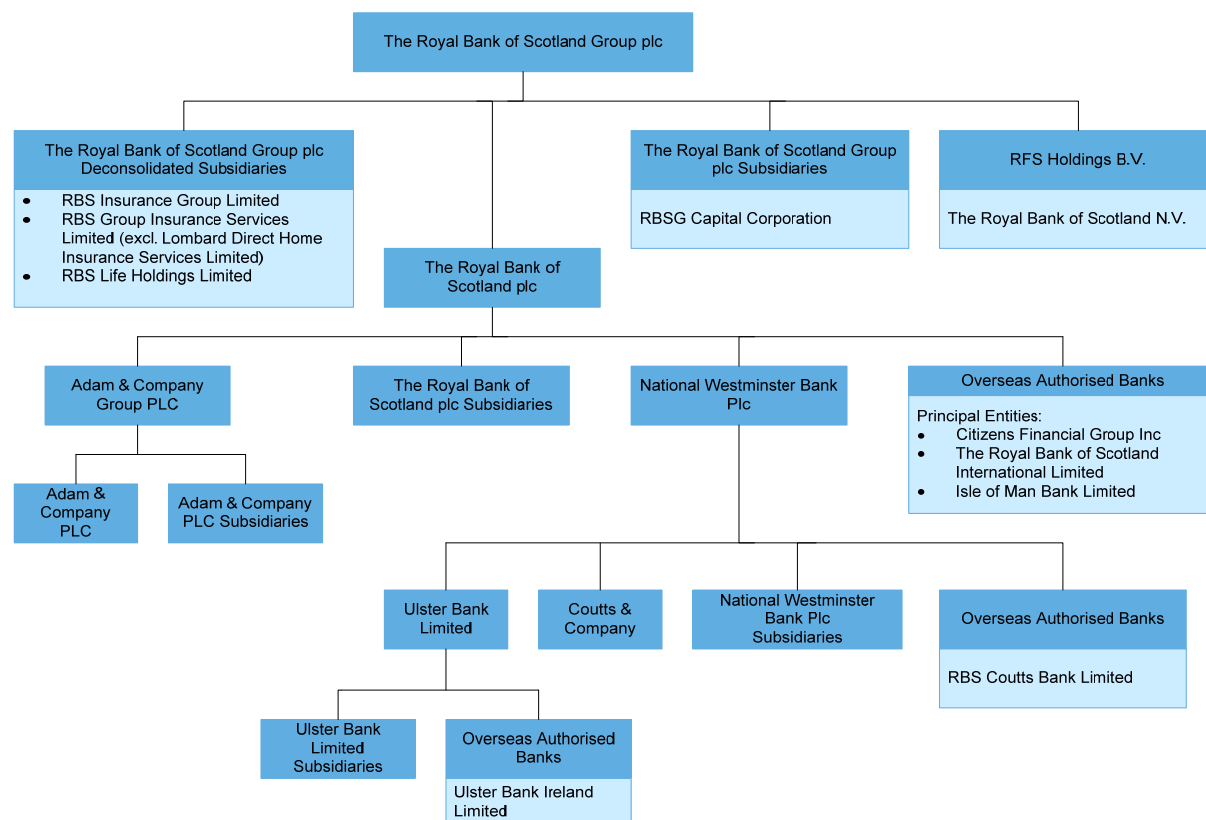
Additionally, with effect from 30 June 2010, RBS N.V. successfully transitioned to the Basel II approach for regulatory reporting and is now included in the relevant IRB or standardised disclosures.

These two significant changes need to be taken into account when comparing the disclosures for 2010 with 2009, which have not been nor are required to be restated.

Scope of application

The Royal Bank of Scotland Group plc is the parent undertaking for all authorised firms in the Group and is subject to consolidated supervision by the FSA. The Pillar 3 disclosure has been prepared for the Group in accordance with BIPRU 11 of the FSA handbook. A summary of the structure of the Group for regulatory reporting purposes is shown below.

Chart 2: Group structure for regulatory reporting purposes



Regulatory and statutory consolidations

Control

Inclusion of an entity in the statutory consolidation is driven by the Group's ability to exercise control over that entity. The regulatory consolidation applies the same test but is restricted to certain categories of entity – non-financial companies and insurers are excluded from the regulatory consolidation. In addition, certain special purpose entities are excluded from the regulatory consolidation in accordance with FSA rules.

Significant influence or joint control

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

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

Individual firms within the Group apply the provisions laid down in BIPRU 2.1 (solo-consolidation waiver) in a limited number of cases only. At 31 December 2010, The Royal Bank of Scotland plc had no solo-consolidated subsidiaries whilst National Westminster Bank Plc had three solo-consolidated subsidiaries. The waiver is only used where the business is an extension of the parent bank's activities undertaken through a subsidiary for commercial reasons and which requires solo-consolidation to ensure that there are no adverse consequences to the capital ratios.

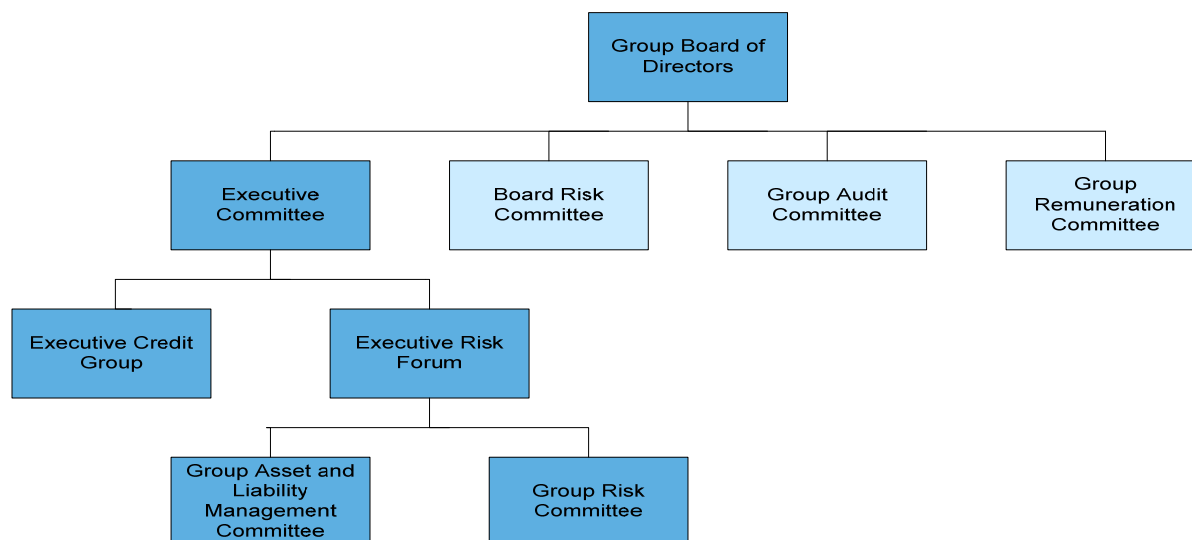
The Group operates on an integrated basis with all Group companies being subject to policies, governance and controls that are set centrally. Aside from regulatory requirements, there are no current or foreseen material, practical or legal impediments to the transfer of capital or prompt repayments of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

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

Governance

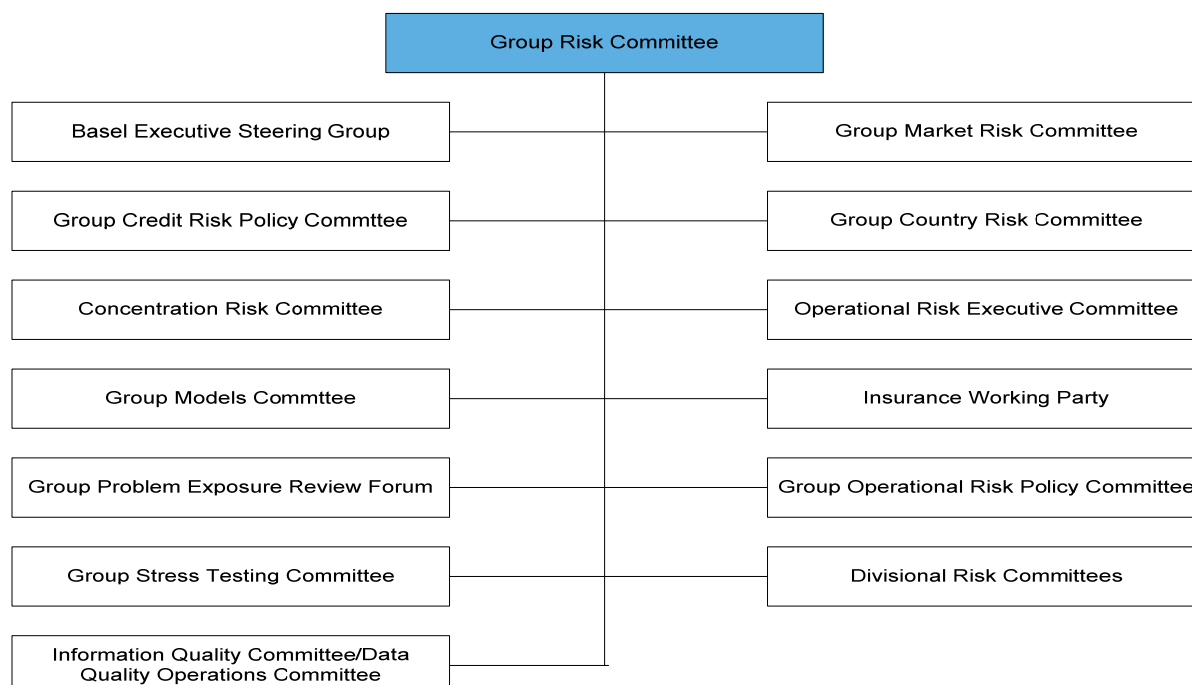
Risk and balance sheet management strategies are owned and set by the Group's Board of directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy, as set out below. Representation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

Chart 3: Risk and capital governance structure



 Comprise independent non-executive directors

Shown below are the specialist risk sub-committees that report into the Group Risk Committee.



Governance continued

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

Committee	Focus	Membership
Group Board	The Group Board is the main decision making forum at Group level. It ensures that the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations.	The Board of directors
Executive Committee (ExCo)	This committee is responsible for managing Group-wide issues and those operational issues material to the broader Group.	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers: US Retail & Commercial and Head of Americas; RBS Insurance; Global Banking & Markets; UK Corporate; and UK Retail, Wealth and Ulster Head of Restructuring and Risk
Board Risk Committee	The Board Risk Committee provides oversight and advice to the Group Board in relation to current and potential future risk exposures of the Group and risk strategy, including determination of risk appetite and tolerance. It reviews the performance of the Group relative to risk appetite and provides oversight of the effectiveness of key Group policies, referred to as the Group Policy Framework.	At least three independent non-executive directors, one of whom is the chairman of the Group Audit Committee
Group Audit Committee (GAC)	The Group Audit Committee is responsible for assisting the Group Board in carrying out its responsibilities relating to accounting policies, internal control and financial reporting functions. It assists on such other matters as may be referred to it by the Group Board and acts as the Audit Committee of the Group Board. The Group Audit Committee also identifies any matters within its remit which it considers that action or improvement is needed and makes recommendations as to the steps to be taken.	At least three independent non-executive directors, at least one of whom is a financial expert as defined in the SEC Rules under the US Exchange Act
Group Remuneration Committee	The Remuneration Committee is responsible for the overview of the Group's remuneration policy and remuneration governance framework, ensuring that remuneration arrangements are consistent with and promote effective risk management. The committee also makes recommendations to the Board on the remuneration arrangements for executive directors.	At least three independent non-executive directors
Executive Credit Group (ECG)	The ECG decides on requests for the extension of existing or new credit limits on behalf of the Board of directors where the proposed aggregate facility limits are in excess of the credit approval authorities granted to individuals in divisions or in RBS Risk Management, or where an appeal against the decline decision of the Group Chief Credit Officer (or delegates) or Group Chief Risk Officer is referred for final decision.	<p>Group A members</p> <p>Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer/Chief Credit Officer RBS N.V. Head of Global Restructuring Group Chief Risk Officer, Non-Core division/APS (alternate)</p> <p>Group B members</p> <p>Group Chief Executive Chief Executive Officers: UK Retail, Wealth and Ulster; US Retail & Commercial and Head of Americas; Global Banking & Markets; RBS Insurance; UK Corporate President, Global Banking & Markets Group Finance Director</p>

Governance continued

The role and remit of these committees continued:

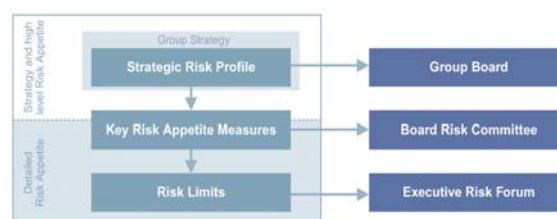
Committee	Focus	Membership
Executive Risk Forum (ERF)	Acts on all strategic risk and control matters across the Group including, but not limited to, credit risk, market risk, operational risk, compliance and regulatory risk, enterprise risk, treasury and liquidity risk, reputational risk, insurance risk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

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

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

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

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



Governance continued

Risk appetite

Risk appetite is an expression of the level of risk that the Group is prepared to accept in order to deliver its business objectives. Risk and balance sheet management across the Group is based on the risk appetite approved by the Board, which regularly reviews and monitors the Group's performance in relation to risk.

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

- *Quantitative*: encompassing scenario stress testing, risk concentration, VaR, liquidity and credit related metrics, business risk and regulatory measures; and

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

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

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

Regulatory developments

Asset Protection Scheme

On 22 December 2009, RBS acceded to the Asset Protection Scheme ('APS' or 'the Scheme'). The key commercial terms and details of the assets covered by the Scheme are set out in Appendix 2.

The effect of the cover provided to the Group under the Scheme has not been reflected in the detailed tables in this document for a number of reasons:

- to aid comparability, both against prior period and against other institutions;
- to aid reconciliation with the Group's 2010 Annual Report and Accounts; and
- to reflect the nature of the cover afforded by the Scheme – there is no reduction in the capital requirements on the assets included within the Scheme while the cover is 'capped'.

Due to the application of the regulatory rules, there is a reduction in RWAs on the covered assets which is replaced by a deduction from capital of the capped first loss arising under the Scheme. The deduction is taken 50% from Core Tier 1 capital and 50% from Tier 2 capital resulting in an improvement in both the Core Tier 1 and Tier 1 capital ratios. This is explained in more detail below and in Appendix 2.

Following accession to the Scheme, HM Treasury provides loss protection against potential losses arising in a pool of assets. HM Treasury also subscribed to £25.5 billion of capital in the form of B shares and a Dividend Access Share with a further £8 billion of capital in the form of B shares potentially available as contingent capital. The Group pays annual fees in respect of the protection and the contingent capital. The Group has a right to terminate the APS at any time provided that the Financial Services Authority has confirmed in writing to HM Treasury that it has no objection to the proposed termination. The Group has the option, subject to HM Treasury consent, to pay the fee premium, contingent capital and the exit fee payable in connection with any termination of the Group's participation in the APS, in whole or in part, by waiving the entitlements of members of the Group to certain UK tax reliefs.

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

On 19 January 2009, the FSA announced that it expects each bank participating in the UK Government's recapitalisation scheme to have a minimum Core Tier 1 capital ratio of 4% on a stressed basis. At 31 December 2010 the Group's Core Tier 1 capital ratio was 10.7% (2009 – 11.0%). While the RWA relief from the APS enabled the Group to maintain robust capital ratios, it is clear that the next few years pose continuing challenges in respect of impairment levels, trading performance and the return to profitability, RWA volatility including procyclical effects, and increasing regulatory demands.

Regulatory capital impact of the APS

Methodology

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

- *First loss* - the residual first loss, after impairments and write-downs, to date, is deducted from available capital split equally between Core Tier 1 and Tier 2 capital;
- *HM Treasury share of covered losses* - after the first loss has been deducted, 90% of assets covered by HM Treasury are risk-weighted at 0%; and
- *RBS share of covered losses* - the remaining 10% share of loss is borne by RBS and is risk-weighted in the normal way.

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

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

Impact

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

Future regulatory capital effects

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

For further information on the APS see appendix 2.

Capital

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

Capital allocation

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

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

Minimum capital and RWAs

Whilst disclosure of RWAs is not a requirement of Pillar 3, RWAs are included in the following table as they remain an important part of the internal management information used by the Group.

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

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

Risk type	2010		2009	
	RWAs £m	Minimum capital requirement (1) £m	RWAs £m	Minimum capital requirement (1) £m
Credit risk	385,819	30,866	513,052	41,044
Counterparty risk	68,142	5,451	56,469	4,517
Market risk	80,105	6,408	65,306	5,224
Operational risk	37,103	2,968	33,910	2,712
Asset Protection Scheme relief	571,169 (105,613)	45,693 (8,449)	668,737 (127,645)	53,497 (10,211)
	465,556	37,244	541,092	43,286

Note:

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

Key points

- Credit and counterparty RWAs fell by £115.6 billion, principally reflecting the transfer of the Dutch States interests following legal separation on 1 April 2010. Excluding the impact of consortium partners, credit and counterparty RWAs fell by £15.8 billion year-on-year principally due to Non-Core disposals partially offset by regulatory and modelling changes.
- Market risk RWAs increased by £14.8 billion during the year principally due to an event risk charge.
- The reduction in APS RWA relief relates to the run-off of covered assets.

Capital continued

The following table details the Group's capital resources.

Table 2: Composition of regulatory capital - statutory

	2010 £m	2009 £m
Tier 1		
Ordinary and B shareholders' equity	70,388	69,890
Non-controlling interests	1,719	16,895
Adjustments for:		
-goodwill and other intangible assets - continuing	(14,448)	(17,847)
-goodwill and other intangible assets - discontinued	-	(238)
-unrealised losses on available-for-sale debt securities	2,061	1,888
-reserves arising on revaluation of property and unrealised gains on available-for-sale equities	(25)	(207)
-reallocation of preference shares and innovative securities	(548)	(656)
-other regulatory adjustments	(1,097)	(1,184)
Less expected loss over provisions net of tax	(1,900)	(2,558)
Less securitisation positions	(2,321)	(1,353)
Less APS first loss	(4,225)	(5,106)
Core Tier 1 capital	49,604	59,524
Preference shares	5,410	11,265
Innovative Tier 1 securities	4,662	5,213
Tax on the excess of expected losses over provisions	758	1,020
Less material holdings	(310)	(601)
Total Tier 1 capital	60,124	76,421
Tier 2		
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	25	207
Collective impairment provisions	778	796
Perpetual subordinated debt	1,852	4,950
Term subordinated debt	16,745	20,063
Minority and other interests in Tier 2 capital	11	11
Less excess of expected losses over provisions	(2,658)	(3,578)
Less securitisation positions	(2,321)	(1,353)
Less material holdings	(310)	(601)
Less APS first loss	(4,225)	(5,106)
Total Tier 2 capital	9,897	15,389
Supervisory deductions		
Unconsolidated investments		
- RBS Insurance	(3,962)	(4,068)
- other investments	(318)	(404)
Other	(452)	(93)
Deductions from total capital	(4,732)	(4,565)
Total regulatory capital	65,289	87,245

Capital continued

The following table details the main terms and conditions of the Group's capital instruments treated as Tier 1 capital under Pillar 1, or Tier 2 capital which includes an incentive for the firm to redeem. The balances disclosed are measured in accordance with IFRS balance sheet carrying amounts which may differ to the amount which the instrument contributes to regulatory capital. Regulatory balances exclude, for example, issuance costs and fair value movements, while dated capital is required to be amortised on a straight-line basis over the final five years of maturity. For accounting purposes the capital instruments below are included within equity or subordinated liabilities, details of which are included within pages 349 to 361 of the Group's 2010 Annual Report and Accounts.

Table 3: Capital instruments

Description	Pillar 1 treatment	Step-up coupon	2010 £m	2009 £m
Hybrid capital securities				
€391 million 6.467% (redeemable June 2012)	Tier 1	3 month EURIBOR plus 2.1%	339	362
US\$318 million (2009 - US\$322 million) 4.709% (redeemable July 2013)	Tier 1	3 month US\$ LIBOR plus 1.865%	190	196
US\$276 million (2009 - US\$470 million) 3 month US\$ LIBOR plus 0.80% (redeemable September 2014)	Tier 1	3 month US\$ LIBOR plus 1.8%	153	261
US\$357 million 5.512% (redeemable September 2014)	Tier 1	3 month US\$ LIBOR plus 1.84%	198	198
€166 million 4.243% (redeemable January 2016)	Tier 1	3 month EURIBOR plus 1.69%	112	112
£93 million 5.6457% (redeemable June 2017)	Tier 1	3 month EURIBOR plus 1.69%	93	93
CAD321 million (2009 - CAD600 million) 6.666% (callable October 2017)	Tier 1	3 month CDOR plus 2.76%	156	293
US\$564 million 6.99% (callable October 2017)	Tier 1	3 month US\$ LIBOR plus 2.67%	275	272
US\$762 million 7.648% perpetual regulatory tier one securities (callable September 2031)	Tier 1	3 month US\$ LIBOR plus 2.5%	494	473
US\$394 million 6.425% (redeemable January 2034)	Tier 1	3 month US\$ LIBOR plus 1.9425%	291	280
US\$486 million 6.8% (perpetual callable September 2009)	Tier 1	-	289	300
US\$1,285 million 5.90% Trust Preferred V	Tier 1	-	633	696
US\$200 million 6.25% Trust Preferred VI	Tier 1	-	100	107
US\$1,800 million 6.08% Trust Preferred VII	Tier 1	-	889	950
US\$65 million (2009 - US\$1,000 million) Series 1 9.118% (redeemable at option of issuer)	Tier 1	-	43	630
£140 million Series A 9% (non-redeemable)	Tier 1	-	144	145
US\$246 million (2009 - US\$300 million) Series C 7.7628%	Tier 1	-	168	193
£0.4 million 5.5% (non-redeemable)	Tier 1	-	0	0
£0.5 million 11% (non-redeemable)	Tier 1	-	1	1
US\$242 million (2009 - US\$300 million) Series H 7.25% (redeemable at option of issuer)	Tier 1	-	156	185
£15 million (2009 - £200 million) Series I 7.387% (redeemable at option of issuer)	Tier 1	-	15	199
US\$751 million (2009 - US\$850 million) Series L 5.75% (redeemable at option of issuer)	Tier 1	-	484	524
US\$578 million (2009 - US\$925 million) Series M 6.4% (redeemable at option of issuer)	Tier 1	-	313	501
€1,250 million Series 1 5.5% (redeemable at option of issuer)	Tier 1	-	860	860
US\$553 million (2009 - US\$1,000 million) Series N 6.35% (redeemable at option of issuer)	Tier 1	-	292	528
€785 million (2009 - €1,250 million) Series 2 5.25% (redeemable at option of issuer)	Tier 1	-	512	815

Capital continued

Table 3: Capital instruments continued

Description	Pillar 1 treatment	Step-up coupon	2010 £m	2009 £m
US\$247 million (2009 - US\$550 million) Series P 6.25% (redeemable at option of issuer)	Tier 1	-	138	306
US\$516 million (2009 - US\$675 million) Series Q 6.75% (redeemable at option of issuer)	Tier 1	-	268	350
US\$254 million (2009 - US\$650 million) Series R 6.125% (redeemable at option of issuer)	Tier 1	-	126	322
US\$156 million (2009 - US\$200 million) Series F 7.65% (redeemable at option of issuer)	Tier 1	-	101	123
US\$661 million (2009 - US\$950 million) Series S 6.6% (redeemable at option of issuer)	Tier 1	-	321	460
€471 million (2009 - €1,300 million) Series 3 7.0916% (callable September 2017)	Tier 1	3 month EURIBOR plus 2.33%	325	895
US\$1,281 million (2009 - US\$1,600 million) Series T 7.25% (redeemable at option of issuer)	Tier 1	-	615	768
US\$1,013 million (2009 - US\$1,500 million) Series U 7.64% (callable September 2017)	Tier 1	3 month US\$ LIBOR plus 2.32%	494	731
£54 million (2009 - £750 million) Series 1 8.162% (redeemable at option of issuer)	Tier 1	3 month EURIBOR plus 2.33%	54	746
Tier 2 capital securities which contain an incentive for the firm to redeem them				
€10 million (2009 - €100 million) floating rate undated step-up notes (callable on any interest payment date)	Upper Tier 2	6 month EURIBOR plus 2.15%	9	90
€178 million (2009 - €400 million) 6.625% fixed/floating rate undated subordinated notes (callable on any interest payment date)	Upper Tier 2	6 month EURIBOR plus 2.15%	154	358
£1 million (2009 - £190 million) 5% undated subordinated notes (callable March 2011)	Upper Tier 2	6 month LIBOR plus 0.75%	2	197
€176 million (2009 - €197 million) 5.125% undated subordinated notes (callable July 2014)	Upper Tier 2	3 month EURIBOR plus 1.65%	166	194
€170 million (2009 - €243 million) floating rate undated subordinated notes (callable July 2014)	Upper Tier 2	3 month EURIBOR plus 1.60%	145	214
£56 million (2009 - £138 million) 6% undated subordinated notes (callable September 2014)	Upper Tier 2	5 year UK Gilts yield plus 1.85%	61	143
£87 million (2009 - £162 million) floating undated subordinated step-up notes (callable January 2015)	Upper Tier 2	5 year UK Gilts yield plus 2.98%	89	174
£54 million (2009 - £178 million) 5.125% undated subordinated notes (callable March 2016)	Upper Tier 2	5 year UK Gilts yield plus 1.95%	58	189
CAD474 million (2009 - CAD700 million) 5.37% fixed rate undated subordinated notes (callable May 2016)	Upper Tier 2	3 month CDOR plus 1.48%	340	452
£51 million (2009 - £117 million) 6.25% undated subordinated notes (callable December 2012)	Upper Tier 2	5 year UK Gilts yield plus 2.35%	55	126
£103 million (2009 - £145 million) 9.5% undated subordinated bonds (callable August 2018)	Upper Tier 2	Higher of 9.5% or 5 year UK Gilts yield plus 2.375%	130	176
£35 million (2009 - £260 million) 5.5% undated subordinated notes (callable December 2019)	Upper Tier 2	5 year UK Gilts yield plus 1.84%	35	272
£21 million (2009 - £174 million) 6.2% undated subordinated notes (callable March 2022)	Upper Tier 2	5 year UK Gilts yield plus 2.05%	43	206
£53 million (2009 - £127 million) 7.125% undated subordinated step-up notes (callable October 2022)	Upper Tier 2	5 year UK Gilts yield plus 3.08%	54	127
£22 million (2009 - £83 million) 5.625% undated subordinated notes (callable September 2026)	Upper Tier 2	5 year UK Gilts yield plus 2.1%	21	90
£19 million (2009 - £201 million) 5.625% undated subordinated notes (callable June 2032)	Upper Tier 2	5 year UK Gilts yield plus 2.41%	20	199
AUD450 million floating rate subordinated notes 2017 (callable February 2012)	Lower Tier 2	3 month BBSW plus 0.78%	295	250

Capital continued

Table 3: Capital instruments continued

Description	Pillar 1 treatment	Step-up coupon	2010 £m	2009 £m
CAD700 million 4.25% subordinated notes 2015	Lower Tier 2	3 month CDOR plus 0.72%	452	419
US\$1,500 million floating rate subordinated notes 2016 (callable April 2011)	Lower Tier 2	3 month US\$ LIBOR plus 0.7%	967	926
US\$500 million floating rate subordinated notes 2016 (callable October 2011)	Lower Tier 2	3 month US\$ LIBOR plus 0.78%	322	308
€500 million 4.5% subordinated notes 2016 (callable January 2011)	Lower Tier 2	3 month EURIBOR plus 0.85%	450	476
€500 million floating rate subordinated notes 2017 (callable June 2012)	Lower Tier 2	3 month EURIBOR plus 0.75%	432	445
AUD410 million floating rate subordinated notes 2014 (callable January 2011)	Lower Tier 2	3 month BBSW plus 0.87%	272	229
AUD590 million 6% subordinated notes 2014 (callable January 2011)	Lower Tier 2	3 month BBSW plus 0.87%	391	330
AUD450 million 6.5% subordinated notes 2017 (callable February 2012)	Lower Tier 2	3 month BBSW plus 0.78%	302	255
US\$1,500 million floating rate subordinated callable step-up notes 2017 (callable August 2012)	Lower Tier 2	3 month US\$ LIBOR plus 0.7%	966	925
CHF200 million 2.375% subordinated notes 2015	Lower Tier 2	3 month CHF LIBOR plus 0.62%	136	117
£60 million 6.375% subordinated notes 2018 (callable April 2013)	Lower Tier 2	3 month LIBOR plus 2.54%	66	66
€5 million floating rate Bermudan callable subordinated notes 2015 (callable October 2011)	Lower Tier 2	3 month EURIBOR plus 1.5%	4	4
AUD175 million floating rate Bermudan callable subordinated notes 2018 (callable May 2013)	Lower Tier 2	3 month BBSW plus 0.79%	111	93
AUD575 million 6.5% Bermudan callable subordinated notes 2018 (callable May 2013)	Lower Tier 2	3 month BBSW plus 0.79%	371	318
US\$1,500 million floating rate Bermudan callable subordinated notes 2015 (callable March 2011)	Lower Tier 2	3 month US\$ LIBOR plus 0.7%	927	887
€1,500 million floating rate Bermudan callable subordinated notes 2015 (callable March 2011)	Lower Tier 2	3 month EURIBOR plus 0.75%	1,283	1,326
€100 million 5.13% flip flop Bermudan callable subordinated notes 2017 (callable December 2012)	Lower Tier 2	3 month EURIBOR plus 0.94%	69	84
€1,000 million 4.625% subordinated notes 2021 (callable September 2016)	Lower Tier 2	3 month EURIBOR plus 1.3%	949	962

Credit risk

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

Credit risk organisation

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

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

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

Credit approval

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

At a minimum, credit relationships are reviewed and re-approved annually. The renewal process addresses: borrower performance, including reconfirmation or adjustment of risk parameter estimates;

the adequacy of security; and compliance with terms and conditions. For certain counterparties early warning indicators are also in place to detect deteriorating trends of concern in limit utilisation or account performance.

Credit risk appetite

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

Product/asset class

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

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

Sector

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

Credit risk continued

Single name concentrations

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

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

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

Country risk

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

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

Credit risk mitigation

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

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

Primary types of credit risk mitigants

The following table details how different risk mitigants are incorporated into IRB risk parameters across both wholesale and retail businesses.

Table 4: Incorporation of credit risk mitigants within IRB risk parameters

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

Credit risk continued

Global Restructuring Group

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

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

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

- *Covenant relief*: the temporary waiver or recalibration of covenants may be granted to mitigate a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan.
- *Amendment of restrictive covenants*: restrictions in loan documents may be amended or waived as part of an overall remedial strategy to allow: additional indebtedness; the granting of collateral; the sale of a business; the granting of junior lien on the collateral; or other fundamental change in capital or operating structure of the enterprise.
- *Variation in margin*: contractual margin may be amended to bolster the customer's day-to-day liquidity, with the aim of helping to sustain the customer's business as a going concern. This would normally be accompanied by the Group receiving an exit payment, payment in kind or deferred fee.
- *Payment holidays and loan rescheduling*: payment holidays or changes to the contracted amortisation profile including extensions in contracted maturity or roll-overs may be granted to improve customer liquidity. Such concessions often depend on the expectation that liquidity will recover when market conditions improve or from capital raising initiatives that access alternative sources of liquidity. Recently, these types of concessions have become more common in commercial real estate transactions in situations when a shortage of market liquidity rules out immediate refinancing and short-term forced collateral sales unattractive.
- *Forgiveness of all or part of the outstanding debt*: debt may be forgiven or exchanged for equity where a fundamental shift in the customer's business or economic environment means that other forms of restructuring strategies are unlikely to succeed in isolation and the customer is incapable of servicing current debt obligations. Debt forgiveness is often an element in leveraged finance

transactions which are typically structured on the basis of projected cash flows from operational activities rather than underlying tangible asset values. Maintaining the business as a going concern with a sustainable level of debt is the preferred option rather than realising the underlying assets, provided that the underlying business model and strategy are considered viable.

Depending on the case in question, GRG may employ a combination of these options in order to achieve the best outcome. It may also consider alternative approaches, either alone or together with the options listed above.

The following are generally considered as options of last resort:

- *Enforcement of security or otherwise taking control of assets*: where the Group holds underlying collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. The Group's preferred strategy is to consider other possible options prior to exercising these rights.
- *Insolvency*: where there is no suitable restructuring option or the business is no longer regarded as sustainable, insolvency will be considered. Insolvency may be the only option that ensures that the assets of the business are properly and efficiently distributed to relevant creditors.

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

Definition of default

The definitions of default used by the Group are as follows:

- *Wholesale businesses*: the BIPRU unlikelihood to pay triggers and 90 days past due rule have been adopted within wholesale credit policy and modelling. Default is measured across all exposures to an obligor and in cases where a credit grade is cascaded to other obligor group members, the default grade will also serve to cross default those obligors.
- *Retail businesses*: credit risk measurement policy defines default as 90 days past due or unlikelihood to pay in full. Whilst BIPRU rules permit 180 days for non small medium sized enterprise portfolios, the Group adopts a uniform 90 days past due definition for its retail portfolios. This facilitates consistency and is closely aligned with operational default and the Group's impairment definition used in International Financial Reporting Standards. Default is measured at the account rather than obligor level. Cross product data is shared through the behaviour score, application score or the use of credit bureau data/scores.

Credit risk continued

Credit risk measurement

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

Probability of default/customer credit grade (PD)

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

- **Wholesale businesses:** as part of the credit assessment process, each counterparty is assigned an internal credit grade derived from a default probability. There are a number of different credit grading models in use across the Group, each of which considers risk characteristics particular to that type of customer. The credit grading models score a combination of quantitative inputs (for example, recent financial performance) and qualitative inputs, (for example, management performance or sector outlook).
- **Retail businesses:** each customer account is separately scored using models based on the most material drivers of default. In general, scorecards are statistically derived using customer data. Customers are assigned a score which in turn, is mapped to a probability of default. The probabilities of default are used to group customers into risk pools. Pools are then assigned a weighted average probability of default using regulatory default definitions.

Exposure at default

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

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

Loss given default

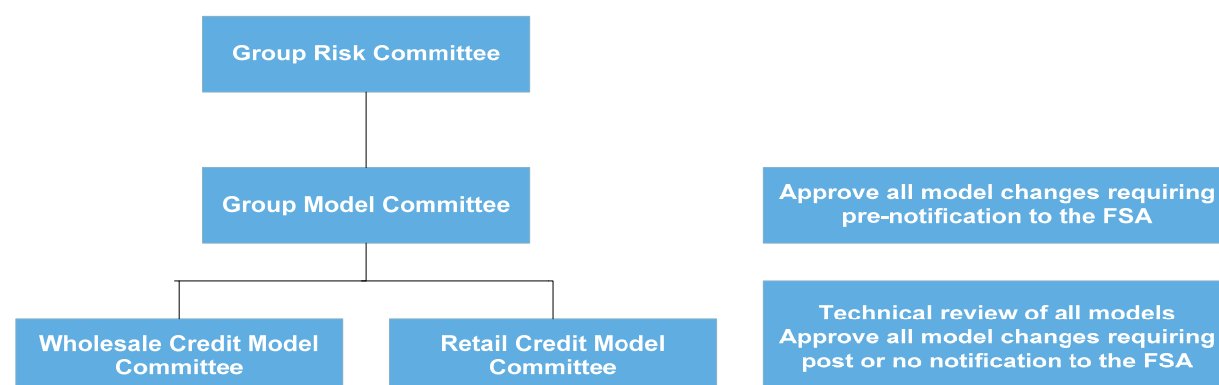
These models estimate the economic loss that may be experienced (the amount that cannot be recovered) by the Group on a credit facility in the event of default. The Group's loss given default (LGD) models take into account both borrower and facility characteristics for unsecured or partially unsecured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

Model review governance

The Group Risk Analytics Model Review Team is responsible for independent oversight of wholesale and retail models and approaches. Two committees, the Wholesale Credit Model Committee and the Retail Credit Model Committee, review and challenge all models. These Committees comprise members of the Group Credit Risk function and senior managers from within divisional credit risk.

Models and model changes that require pre-notification to the FSA before implementation are approved by the Group Model Committee, which is a sub committee of Group Risk Committee. The Group Model Committee is the designated committee for model approvals for the Group. The internal model review and approval process and governance arrangements are detailed in the chart below:

Chart 4: Governance structure for model review and approval



Credit risk continued

Model validation

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

Independent model validation is performed by the Group. This includes an evaluation of the model development and validation for the data set used, logic and assumptions, and performance of the model analysis.

The validation results are a key factor in deciding whether a model is recommended for ongoing use. The frequency, depth and extent of

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

- **Developmental evidence:** to ensure that the credit risk model adequately discriminates between different levels of risk and delivers accurate risk estimates.
- **Process verification:** whether the methods used in the credit risk models are being used, monitored and updated in the way intended in the design of the model. Initial testing and validation is performed when the model is developed with the performance of models being assessed on an ongoing basis.

Table 5: Credit risk RWAs and minimum capital requirement

Credit risk approach	2010		2009	
	Credit RWAs (1) £m	Minimum capital requirement £m	Credit RWAs (1) £m	Minimum capital requirement £m
Advanced IRB	270,767	21,662	249,842	19,987
Standardised	115,052	9,204	99,976	7,998
Counterparty credit risk	68,142	5,451	56,469	4,517
	453,961	36,317	406,287	32,502
ABN AMRO - Basel I	-	-	163,234	13,059
	453,961	36,317	569,521	45,561
Of which - non-controlling interests	2,879	230	102,621	8,210
	451,082	36,087	466,900	37,351

Note:

(1) Credit RWAs include both intra-group and non-customer assets.

Key points

- The exposures held in RBS N.V. transitioned from Basel I to Basel II approach on 30 June 2010. At 31 December 2010 credit RWAs in RBS N.V. totalled £75.6 billion. The residual credit RWAs attributable to Consortium Members was £2.9 billion.
- In addition certain Central bank exposures in North America previously treated under the Standardised approach transitioned to the advanced IRB approach.

A detailed analysis of the approaches is contained in the sections that follow. Exposure, as shown in these credit disclosures, is defined as exposure at default (EAD). This is an estimate of the expected level of utilisation of a credit facility at the time of default and will be equal to or greater than the drawn exposure.

Credit risk continued

Credit risk by advanced IRB approach

The following table details the Group's credit RWAs and minimum capital requirements by advanced IRB exposure class and sub-class. These balances include non-customer assets.

Table 6: Credit risk RWAs and minimum capital requirement by advanced IRB exposure class

Advanced IRB exposure class and sub-class (1)	2010		2009	
	Credit RWAs £m	Minimum capital requirement £m	Credit RWAs £m	Minimum capital requirement £m
Central governments and central banks	3,432	275	527	42
Institutions	8,758	701	2,440	195
Corporates	169,226	13,538	154,601	12,368
Retail	65,478	5,238	65,742	5,259
Retail SME	12,785	1,023	15,096	1,208
Retail secured by real estate collateral	30,619	2,449	25,815	2,065
Qualifying revolving retail exposures	13,424	1,074	13,413	1,073
Other retail exposures	8,650	692	11,418	913
Equities (2)	5,191	415	3,514	281
Exchange traded exposures	1,041	83	684	55
Private equity exposures	1,679	134	1,572	126
Other exposures	2,471	198	1,258	100
Securitisation positions	10,261	821	13,621	1,090
Non-credit obligation assets	8,421	674	9,397	752
	270,767	21,662	249,842	19,987

Notes:

- (1) Excludes over-the-counter (OTC) and repurchase agreements (repos).
- (2) Equity exposures treated through the PD/LGD approach in 2010 have a minimum capital requirement of £321 million (2009 - £142 million). Equity exposures treated through the simple risk weight approach in 2010 have a minimum capital requirement of £94 million (2009 - £139 million).

Key points

- Advanced IRB RWAs rose by 8.4%. The main driver of this movement was the transition of the RBS N.V. portfolio into the Group's advanced IRB models coupled with other modelling changes.
- Excluding the RBS N.V. transition, credit risk RWAs fell by 10% or £25.2 billion, as the Group ran-down parts of its Non-Core business. This combined with the disposal of portfolios targeted for mandated sale by the European Commission, led to a further reduction in advanced IRB RWAs.

These trends can be observed in greater detail in the tables that follow.

Credit risk continued

Gross advanced IRB customer credit risk

The following tables detail the Group's gross customer advanced IRB credit risk by exposure class, geographic area, industry sector and residual maturity band. The gross customer exposure is shown as the EAD before the application of credit risk mitigation (CRM), excluding products calculated under the counterparty credit risk approach.

Table 7: Advanced IRB gross average exposure at default

Advanced IRB exposure class	2010		2009	
	EAD pre CRM (1,2)	Average EAD pre CRM (3)	EAD pre CRM (1,2)	Average EAD pre CRM (3)
	£m	£m	£m	£m
Central governments and central banks	100,968	84,441	16,006	25,332
Institutions	33,319	34,923	10,603	20,099
Corporates	339,293	355,740	303,369	332,793
Retail	179,936	177,845	175,948	172,943
Equities	1,686	2,259	1,407	1,460
Securitisation positions	53,640	61,897	54,608	59,754
Non-credit obligation assets (4)	5,047	4,840	3,987	3,676
	713,889	721,945	565,928	616,057

Notes:

- (1) EAD pre CRM is before the application of on-balance sheet netting.
- (2) EAD excludes non-customer assets along with OTC and repo products, which are shown separately in the counterparty credit risk disclosures.
- (3) Average EAD for both 2009 and 2010 is based on the full year.
- (4) Non-credit obligation assets refer to the residual value of leases only.

Key points

- The overall increase in EAD pre CRM of £148.0 billion is mainly due to the transition of RBS N.V. exposures into the Group Basel II advanced IRB models in June 2010. This accounted for £123.7 billion or 83.6% of the total exposure increase, and can be seen primarily in central governments and central banks, corporates and institutions exposure classes.
- The increase of £84.9 billion in central government and banks exposures was also due to increased purchases of government bonds and placements in line with the Group's liquidity targets for 2010 for both The Royal Bank of Scotland plc and RBS N.V. This is aligned to the Group's funding goals to ensure the availability of short-term, high-quality, liquid securities.

Credit risk continued

Table 8: Advanced IRB gross exposure at default by geographic area

Advanced IRB exposure class	UK £m	North America £m	Western Europe (excl. UK) £m	Asia and Pacific £m	Latin America £m	CEE and Central Asia £m	Middle East and Africa £m	Total £m
2010 (1,2,3)								
Central governments and central banks	6,645	33,944	48,615	9,943	164	1,275	382	100,968
Institutions	4,177	4,356	13,558	7,743	1,372	1,001	1,112	33,319
Corporates	152,132	35,583	99,718	21,909	11,788	7,903	10,260	339,293
Retail	157,795	195	21,316	348	76	60	146	179,936
Equities	693	97	495	177	206	5	13	1,686
Securitisation positions	10,346	16,045	13,518	4,388	9,258	53	32	53,640
Non-credit obligation assets (4)	839	181	2,461	842	387	191	146	5,047
	332,627	90,401	199,681	45,350	23,251	10,488	12,091	713,889
2009 (1,2,3)								
Central governments and central banks	5,256	1,592	6,004	3,085	-	5	64	16,006
Institutions	1,508	899	4,168	2,353	986	144	545	10,603
Corporates	161,042	32,243	73,482	14,498	10,213	3,067	8,824	303,369
Retail	150,913	286	23,311	653	226	179	380	175,948
Equities	853	123	307	-	124	-	-	1,407
Securitisation positions	11,880	18,344	9,637	4,231	10,424	61	31	54,608
Non-credit obligation assets (4)	879	200	1,564	669	320	182	173	3,987
	332,331	53,687	118,473	25,489	22,293	3,638	10,017	565,928

Notes:

- (1) EAD pre CRM is before the application of on-balance sheet netting.
- (2) EAD excludes non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) The geographic area is determined by the country of incorporation for companies. For individuals, it is the country of residence.
- (4) Non-credit obligation assets refer to the residual value of leases only.

Key points

- The RBS N.V. integration accounted for an increase of £71 billion in Western Europe (excl. UK), £19 billion in Asia Pacific and £14 billion in North America. Other movements in North America are due to a change in Basel II methodology to include exposures previously treated under the standardised basis, combined with increased higher quality sovereign exposures as part of the Group's liquidity targets.
- Countries in Asia that have seen exposures increase during 2010 include China and India, two of the Group's strategically important countries in this region.
- The retail portfolio showed an increase due to continued strong growth and lower redemption rates in the UK mortgage business lines, which grew by 5%. Of this total portfolio, 98% relates to Core business. These assets mostly comprise prime mortgage lending and exposure to residential buy-to-let.

Credit risk continued

Table 9: Advanced IRB gross exposure at default by industry sector (1,2)

Sector cluster	Central governments and central	Institutions	Corporates	Retail	Equities	Securitisation	Non-credit	Total
	banks					positions	obligation	
	£m	£m	£m	£m	£m	£m	assets	£m
2010 (3)								
Banks	4,228	33,016	552	-	131	-	107	38,034
Financial guarantors	-	-	6	-	-	-	-	6
Hedge funds	-	-	557	-	-	-	-	557
Insurers and funds	-	-	13,628	127	401	-	76	14,232
Manufacturing (cyclical)	-	-	17,861	381	9	-	3	18,254
Manufacturing (non-cyclical)	-	-	16,066	2,928	25	-	14	19,033
Natural resources	153	-	36,702	76	21	-	49	37,001
Non-bank financial institutions	245	303	24,503	114	429	2,365	24	27,983
Personal	-	-	1,545	159,584	-	-	-	161,129
Property	-	-	105,641	6,203	330	42	187	112,403
Retail & Leisure	2	-	29,601	4,494	142	661	314	35,214
Securitisations	-	-	3,201	-	-	50,361	-	53,562
Services	174	-	25,668	4,616	77	112	30	30,677
Sovereigns and quasi sovereigns	96,084	-	287	27	-	-	114	96,512
Technology, media and telecommunications	-	-	18,629	431	111	-	70	19,241
Transport	82	-	44,846	955	10	99	4,059	50,051
	100,968	33,319	339,293	179,936	1,686	53,640	5,047	713,889
2009 (3)								
Banks	8	10,603	432	2	25	224	94	11,388
Financial guarantors	-	-	-	-	-	-	-	-
Hedge funds	-	-	-	-	-	-	-	-
Insurers and funds	-	-	10,406	-	541	2,228	72	13,247
Manufacturing (cyclical)	-	-	12,310	275	10	346	4	12,945
Manufacturing (non-cyclical)	-	-	12,520	1,881	1	-	25	14,427
Natural resources	-	-	26,648	138	30	998	9	27,823
Non-bank financial institutions	-	-	18,060	264	354	44,646	6	63,330
Personal	-	-	2,602	157,489	-	-	-	160,091
Property	214	-	115,850	6,801	308	1,581	192	124,946
Retail and leisure	1	-	29,447	5,991	17	1,608	164	37,228
Services	157	-	20,985	2,260	67	1,170	4	24,643
Sovereigns and quasi sovereigns	15,545	-	357	26	7	-	106	16,041
Technology, media and telecommunications	-	-	15,561	96	24	515	14	16,210
Transport	81	-	38,191	725	23	1,292	3,297	43,609
	16,006	10,603	303,369	175,948	1,407	54,608	3,987	565,928

Notes:

- (1) The Group has implemented a new mapping of sector exposures that are aligned to the sector concentration framework. This mapping has also been applied against the 2009 data.
- (2) EAD excludes non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures. EAD pre CRM is before the application of on-balance sheet netting.
- (3) Industry sectors are determined using the standard industrial classification (SIC) codes of the counterparty.

Key points

- Group exposures increased by £148.0 billion, mainly driven by the inclusion of credit exposures from RBS N.V..
- The property sector exposures saw the largest reduction, with an offsetting increase noted within the sovereigns and quasi sovereigns sector driven by increased liquidity placements with highly-rated central governments and central bank counterparties. The increase in sovereign sector was also driven by the transition of certain exposures from the Basel II standardised basis to the advanced IRB approach.
- The introduction of the securitisations sector cluster in 2010 led to a migration of exposure into this sector from non-bank financial institutions.

Credit risk continued

Table 10: Advanced IRB gross exposure at default by residual maturity

Advanced IRB exposure class	Within 1 year (5) £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
2010 (1,2,3)				
Central governments and central banks	53,190	19,981	27,797	100,968
Institutions	20,984	8,137	4,198	33,319
Corporates	114,477	152,988	71,828	339,293
Retail	32,674	18,390	128,872	179,936
Equities	-	-	1,686	1,686
Securitisation positions	22,886	10,384	20,370	53,640
Non-credit obligation assets (4)	323	1,870	2,854	5,047
	244,534	211,750	257,605	713,889
2009 (1,2,3)				
Central governments and central banks	9,504	3,237	3,265	16,006
Institutions	7,729	2,281	593	10,603
Corporates	81,103	145,605	76,661	303,369
Retail	31,668	15,875	128,405	175,948
Equities	-	-	1,407	1,407
Securitisation positions	26,645	10,629	17,334	54,608
Non-credit obligation assets (4)	603	1,120	2,264	3,987
	157,252	178,747	229,929	565,928

Notes:

- (1) EAD pre CRM is before the application of on-balance sheet netting.
- (2) EAD excludes non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) The maturity bandings represent the residual contractual maturity.
- (4) Non-credit obligation assets refer to the residual value of leases only.
- (5) Revolving facilities are included in the 'within 1 year' category.

Key points

- Large increases in exposure occurred in all maturity bands within the central governments and central banks exposure class. This was most notable for maturities within 1 year and was driven by increased liquidity placements with highly rated central governments and central banks. There was also a transfer of sovereign exposures from the Basel II standardised to the advanced IRB approach.
- Large reductions occurred in the corporate exposure class within maturities after 5 years, driven by a reduction in term loan exposures to counterparties in the property sector.

Credit risk continued

Asset quality of advanced IRB customer credit risk and counterparty credit risk

The Group utilises a master grading scale (MGS) for wholesale exposures which comprises 27 grades. These in turn map to ten asset quality (AQ) bands used for both wholesale and retail exposures. The relationship between these measures is detailed in the following table. The use of grades and PD estimates within the credit risk management frameworks and processes is discussed on page 19.

Table 11: Master grading scale mapping to asset quality bands

Master grading scale	PD Range		Asset quality bands
	Lower	Upper	
1	0%	0.006%	AQ1
2	0.006%	0.012%	
3	0.012%	0.017%	
4	0.017%	0.024%	
5	0.024%	0.034%	
6	0.034%	0.048%	AQ2
7	0.048%	0.050%	AQ3
8	0.050%	0.095%	
9	0.095%	0.135%	
10	0.135%	0.190%	AQ4
11	0.190%	0.269%	
12	0.269%	0.381%	
13	0.381%	0.538%	AQ5
14	0.538%	0.761%	
15	0.761%	1.076%	
16	1.076%	1.522%	AQ6
17	1.522%	2.153%	AQ7
18	2.153%	3.044%	
19	3.044%	4.305%	
20	4.305%	6.089%	
21	6.089%	8.611%	AQ8
22	8.611%	12.177%	
23	12.177%	17.222%	
24	17.222%	24.355%	AQ9
25	24.355%	34.443%	
26	34.443%	100%	
27	100%	100%	AQ10

Credit risk continued

The following tables detail the key parameters of the advanced IRB RWA calculation for each of the exposure classes. They include over-the-counter derivatives and repo products which are also detailed in the counterparty credit risk disclosure, but exclude products where no PD exists such as securitisation positions and non-customer assets.

Table 12: Central governments and central banks by asset quality band

Asset quality band	EAD post CRM (1) £m	Exposure weighted average LGD (2) %	Exposure weighted average risk-weight (2) %	Undrawn commitments (3) £m	Undrawn weighted average CCF (4) %
2010					
AQ1	106,837	8.9	1.8	36,563	7.6
AQ2	590	51.9	15.7	183	4.8
AQ3	1,524	38.6	25.1	361	8.7
AQ4	2,047	47.3	59.4	577	14.5
AQ5	397	29.5	47.7	378	15.8
AQ6	55	19.7	54.8	106	38.0
AQ7	174	27.1	82.4	22	85.4
AQ8	8	9.8	45.7	-	-
AQ9	-	-	-	-	-
AQ10/default	-	-	-	-	-
	111,632	10.4	3.6	38,190	8.0
2009					
AQ1	36,544	11.7	3.0	16,686	12.8
AQ2	169	41.2	5.5	46	23.6
AQ3	246	29.6	25.9	36	41.8
AQ4	68	61.1	63.2	185	24.5
AQ5	215	21.1	46.4	196	64.0
AQ6	74	43.9	108.7	53	22.0
AQ7	43	49.8	169.7	1	42.0
AQ8	-	-	-	-	-
AQ9	-	-	-	-	-
AQ10/default	-	-	-	-	-
	37,359	12.2	3.9	17,203	13.6

Notes:

- (1) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (2) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (3) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (4) Undrawn weighted average credit conversion factor (CCF) has been weighted by the sum of undrawn commitments within each of the PD bands.

Key points

- The significant increase of £70.3 billion within AQ1 was due to the combined effect of the RBS N.V. transition, and the increased purchases of central government bonds in line with the Group's liquidity targets.
- Increases in AQ3 and AQ4 were driven by new sovereign exposures to India, Greece, Dubai and Kazakhstan as a result of the RBS N.V. transition.

Credit risk continued

Table 13: Institutions by asset quality band

Asset quality band	EAD post CRM (1) £m	Exposure weighted average LGD (2) %	Exposure weighted average risk-weight (2) %	Undrawn commitments (3) £m	Undrawn weighted average CCF (4) %
2010					
AQ1	80,108	34.2	22.0	47,410	4.6
AQ2	1,659	48.1	44.7	1,106	11.0
AQ3	3,179	50.8	59.8	1,973	6.3
AQ4	1,433	51.2	80.3	1,810	12.8
AQ5	726	54.9	138.3	533	7.6
AQ6	95	60.4	227.5	101	7.1
AQ7	395	46.9	159.0	173	5.0
AQ8	44	54.2	286.1	41	6.3
AQ9	42	63.0	108.3	5	2.9
AQ10/default (5)	153	82.1	-	20	34.8
	87,834	35.7	26.7	53,172	5.2
2009 (6)					
AQ1	63,086	33.3	23.1	33,296	3.2
AQ2	764	44.4	50.0	109	16.5
AQ3	1,600	47.1	45.7	1,052	21.8
AQ4	444	53.1	71.5	405	16.9
AQ5	85	55.4	174.4	41	12.1
AQ6	148	51.0	170.0	147	6.4
AQ7	121	49.6	178.2	55	18.0
AQ8	-	-	-	1	5.1
AQ9	-	-	-	3	7.5
AQ10/default (5)	104	47.6	-	-	-
	66,352	34.0	25.0	35,109	4.0

Notes:

- (1) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (2) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (3) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (4) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.
- (5) Low risk-weight in AQ10 is caused by Best Estimate of Expected Loss (BEEL) methodology on defaulted assets, based on downturn LGD. This may result in nil RWAs for defaulted assets as the Group takes a capital deduction equal to the difference between expected loss and provisions.

Key point

- A £21.5 billion increase in institutional exposures was observed, of which £24.7 billion was due to the RBS N.V. transition. Offsetting this increase was a reduction within band AQ1 reflecting reduced over the counter derivative exposures connected with the Sempra JV disposal.

Credit risk continued

Table 14: Corporates by asset quality band

Asset quality band	EAD post CRM (1) £m	Exposure weighted average LGD (2) %	Exposure weighted average risk-weight (2) %	Undrawn commitments (3) £m	Undrawn weighted average CCF (4) %
2010					
AQ1	86,668	28.2	13.1	66,569	29.1
AQ2	21,026	34.7	18.8	17,726	28.3
AQ3	30,299	32.7	21.7	26,432	29.8
AQ4	50,602	33.4	43.3	26,290	30.6
AQ5	57,125	30.3	67.5	16,119	35.9
AQ6	39,712	29.8	87.3	8,326	39.7
AQ7	26,424	38.8	137.2	4,383	43.8
AQ8	8,971	38.8	179.9	637	53.6
AQ9	12,629	48.3	314.3	1,639	35.7
AQ10/default (5)	35,105	48.8	0.6	2,319	74.4
	368,561	33.8	56.8	170,440	31.7
Corporates under the project finance supervisory slotting approach					
Category 1	11,612		65.5	1,571	59.9
Category 2	574		84.8	118	54.3
Category 3	840		115.0	129	87.8
Category 4	363		250.0	52	85.0
Category 5	22		-	-	-
	13,411		74.3	1,870	62.2
2009 (6)					
AQ1	64,339	27.4	12.1	44,747	28.4
AQ2	15,514	32.1	14.6	9,904	35.9
AQ3	26,842	31.6	17.0	20,092	35.0
AQ4	48,396	30.2	31.2	19,773	39.1
AQ5	68,715	30.6	62.9	17,083	43.5
AQ6	43,651	33.5	91.0	8,510	48.9
AQ7	28,095	38.0	126.5	4,706	48.8
AQ8	9,098	37.0	173.1	881	59.0
AQ9	10,199	48.2	290.6	899	57.6
AQ10/default (5)	28,559	39.4	1.1	2,529	80.5
	343,408	32.5	56.5	129,124	37.1

Notes:

- (1) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (2) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (3) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (4) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.
- (5) Low risk-weight in AQ10 is caused by BEEL methodology on defaulted assets, based on downturn LGD. This may result in a nil RWA for defaulted assets as a capital deduction is taken equal to the difference between expected loss and provisions.
- (6) Project finance slotting was introduced in 2010, hence it is not separately disclosed for 2009.

Key points

- The Group exposure has increased by £25.2 billion. The increase was mainly driven by the inclusion of credit exposures from RBS N.V. offset by reductions in the rest of the portfolio.
- Excluding the effect of the RBS N.V. transition, exposures were managed down through the year as part of the Non-Core disposal strategy. Significant sales occurred in the leveraged finance, project finance, commercial property and structured finance portfolios.
- Further reductions in advanced IRB exposures were noted as project finance counterparties were transitioned to the supervisory slotting methodology for specialised lending, as required by the FSA.
- The increase in AQ10 is attributable to exposures in Ulster Bank where weakness in the Irish property market continues to impact portfolio trends and the stock of defaulted assets continues to grow.

Credit risk continued

Table 15: Equities by asset quality band (1)

Asset quality band	EAD post CRM (2) £m	Exposure weighted average LGD (3) %	Exposure weighted average risk-weight (3) %	Undrawn commitments (4) £m	Undrawn weighted average CCF (5) %
2010					
AQ1	-	-	-	-	-
AQ2	-	-	-	-	-
AQ3	5	90.0	194.2	-	-
AQ4	-	-	-	-	-
AQ5	-	-	-	-	-
AQ6	760	90.0	279.3	-	-
AQ7	419	90.0	332.8	-	-
AQ8	6	90.0	569.6	-	-
AQ9	142	90.0	12.2	-	-
AQ10/default (5)	23	90.0	-	-	-
	1,355	90.0	264.2	-	-
Equities calculated using simple risk-weight approach					
Private equity exposures	319	-	370.0	93	100
Other equity exposures	1	-	190.0	-	-
	320	-	369.6	93	100
	1,675				
2009					
AQ1	-	-	-	-	-
AQ2	-	-	-	-	-
AQ3	5	90.0	193.1	-	-
AQ4	5	90.0	173.5	-	-
AQ5	2	90.0	213.6	-	-
AQ6	425	90.0	301.2	-	-
AQ7	139	90.0	332.3	-	-
AQ8	-	-	-	-	-
AQ9	1	90.0	585.5	-	-
AQ10/default (5)	11	90.0	-	-	-
	588	90.0	301.2	-	-
Equities calculated using simple risk-weight approach					
Private equity exposures	716	-	190.0	227	100
Other equity exposures	103	-	370.0	64	100
	819	-	212.7	291	100
	1,407				

Notes:

- (1) Excludes equity exposures calculated under the simple risk-weight approach.
- (2) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (3) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (4) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (5) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.
- (6) Low risk-weight in AQ10 is caused by BEEL methodology on defaulted assets, based on downturn LGD. this may result in a nil RWA for defaulted assets as the Group takes a capital deduction equal to the difference between expected loss and provisions.

Key point

- The reduction in private equity exposures under the simple risk-weight approach was due to the reduction of the RBS Special Opportunities Funds' exposures to insurers and non-bank financial institutions. This was offset by an increase in equity exposures under the PD/LGD approach as a result of several debt-to-equity swaps.

Credit risk continued

Table 16: Retail small and medium sized enterprises (SME) by asset quality band (1)

Asset quality band	EAD post CRM (2) £m	Exposure weighted average LGD (3) %	Exposure weighted average risk-weight (3) %	Undrawn commitments (4) £m	Undrawn weighted average CCF (5) %
2010					
AQ1	-	-	-	-	-
AQ2	15	49.3	7.6	11	100
AQ3	2	58.3	9.1	1	100
AQ4	1,238	73.6	28.6	888	100
AQ5	1,338	42.2	42.3	200	100
AQ6	7,573	41.4	56.2	1,027	100
AQ7	5,276	39.4	64.3	150	100
AQ8	2,221	41.9	84.5	114	100
AQ9	1,139	43.2	128.7	27	100
AQ10/default	1,680	57.4	51.6	-	-
	20,482	44.4	62.4	2,418	100
2009					
AQ1	-	-	-	-	-
AQ2	-	-	-	-	-
AQ3	-	-	-	-	-
AQ4	710	75.1	39.8	598	100
AQ5	591	73.1	64.7	345	100
AQ6	7,786	41.6	58.3	1,186	100
AQ7	5,570	39.5	63.9	175	100
AQ8	3,986	42.1	81.8	214	100
AQ9	1,718	42.4	124.3	46	100
AQ10/default	1,507	60.3	61.9	-	-
	21,868	44.5	69.0	2,564	100

Notes:

- (1) Retail SME exposures consist primarily of loans and overdrafts to SME's treated through the retail IRB approach.
- (2) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (3) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (4) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (5) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.

Key points

- Retail SME exposures are concentrated within UK Business Banking where a reduction was most notable within business loans. There was some exposure migration as counterparties previously concentrated within AQ6 to 9 moved up to AQ2 to 5.
- The improved overall quality of the underlying book, drove a reduction in the average risk-weight. Undrawn commitment reductions, most notable within business overdrafts, have been marginal and are reflected in the overall exposure movements.

Credit risk continued

Table 17: Retail secured by real estate by asset quality band (1)

Asset quality band	EAD post CRM (2) £m	Exposure weighted average LGD (3) %	Exposure weighted average risk-weight (3) %	Undrawn commitments (4) £m	Undrawn weighted average CCF (5) %
2010					
AQ1	-	-	-	-	-
AQ2	2,990	5.0	0.6	1,710	100.0
AQ3	-	-	-	-	-
AQ4	23,701	6.7	3.5	1,836	100.0
AQ5	40,749	10.1	10.2	2,885	89.4
AQ6	31,718	16.9	27.6	910	99.8
AQ7	12,788	17.8	51.3	135	99.5
AQ8	2,703	15.2	74.5	7	99.3
AQ9	3,799	19.7	114.4	-	-
AQ10/default	3,783	18.4	104.3	33	100.0
	122,231	12.6	25.1	7,516	95.9
2009					
AQ1	-	-	-	-	-
AQ2	3,285	5.0	0.6	1,719	100.0
AQ3	2	19.0	2.9	-	-
AQ4	27,742	8.2	4.2	1,820	100.0
AQ5	35,101	11.8	11.8	1,565	98.8
AQ6	33,754	14.6	27.2	1,949	88.5
AQ7	7,826	14.7	41.6	113	99.8
AQ8	2,641	15.9	78.8	4	100.0
AQ9	2,797	17.3	101.7	-	-
AQ10/default	2,641	16.5	118.0	47	100.0
	115,789	12.1	22.3	7,217	96.6

Notes:

- (1) Retail secured by real estate exposures consist of mortgages treated through the retail IRB approach.
- (2) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (3) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (4) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (5) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.

Key point

- The overall increase in EAD post CRM of £6.4 billion was due to strong new mortgage lending in 2010 within the UK. Despite an improvement in the average LTV for new business, the slight increase in LGDs was due to the combined effect of changes to LGD discount rates, recalibration of several LGD models, and lower recoveries on Irish residential property.

Credit risk continued

Table 18: Qualifying revolving retail exposures by asset quality band (1)

Asset quality band	EAD post CRM (2) £m	Exposure weighted average LGD (3) %	Exposure weighted average risk-weight (3) %	Undrawn commitments (4) £m	Undrawn weighted average CCF (5) %
2010					
AQ1	106	8.9	0.2	2,434	4.2
AQ2	6,087	77.0	2.2	4,666	100.0
AQ3	-	-	-	-	-
AQ4	3,844	74.8	7.7	2,940	88.8
AQ5	5,453	72.2	20.9	14,893	21.7
AQ6	3,652	72.3	41.1	6,294	28.7
AQ7	2,822	72.9	83.2	1,811	43.5
AQ8	3,721	77.6	154.2	742	68.4
AQ9	739	82.3	269.4	55	92.8
AQ10/default	1,113	77.7	24.5	265	0.1
	27,537	74.7	48.7	34,100	40.4
2009					
AQ1	38	20.2	0.5	1,069	3.6
AQ2	1,103	79.8	2.4	917	95.2
AQ3	1,120	65.1	3.6	602	100.0
AQ4	6,449	78.1	6.7	5,142	93.9
AQ5	5,890	73.6	22.9	17,735	27.6
AQ6	3,444	71.7	41.6	4,817	40.6
AQ7	2,715	72.0	80.3	1,685	53.0
AQ8	3,791	77.3	149.6	974	79.9
AQ9	768	81.3	263.7	68	100.0
AQ10/default	1,138	78.2	22.5	195	0.2
	26,456	75.0	50.7	33,204	45.0

Notes:

- (1) Qualifying revolving retail exposures consist primarily of personal credit card and overdraft exposures treated through the retail IRB approach.
- (2) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (3) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (4) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (5) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.

Key point

- A migration was observed in the overall portfolio, as exposures moved upwards from AQ3, AQ4 and AQ5 to AQ2. This is largely attributable to redemptions of the cards securitisation pool.

Credit risk continued

Table 19: Other retail by asset quality band (1)

Asset quality band	EAD post CRM (2) £m	Exposure weighted average LGD (3) %	Exposure weighted average risk-weight (3) %	Undrawn commitments (4) £m	Undrawn weighted average CCF (5) %
2010					
AQ1	-	-	-	-	-
AQ2	-	-	-	-	-
AQ3	-	-	-	-	-
AQ4	140	78.4	43.3	1	100.0
AQ5	635	62.1	60.3	2	100.0
AQ6	2,929	74.9	93.4	1	100.0
AQ7	1,888	73.0	111.0	-	-
AQ8	1,535	74.1	132.3	-	-
AQ9	401	72.7	204.0	-	-
AQ10/default	2,158	80.3	24.4	-	-
	9,686	74.7	89.3	4	100.0
2009					
AQ1	-	-	-	-	-
AQ2	-	-	-	-	-
AQ3	-	-	-	-	-
AQ4	144	80.6	45.4	1	100.0
AQ5	565	64.0	64.7	2	100.0
AQ6	3,474	74.6	94.5	-	-
AQ7	2,708	73.8	112.7	1	100.0
AQ8	2,103	72.8	132.4	-	-
AQ9	662	72.7	203.1	-	-
AQ10/default	2,180	80.2	24.0	-	-
	11,836	74.6	96.5	4	100.0

Notes:

- (1) Other retail exposures consist primarily of unsecured personal loans treated through the retail IRB approach.
- (2) EAD post CRM is exposure at default after the application of on balance sheet netting and includes the advanced IRB element of counterparty credit risk but excludes non-customer assets.
- (3) Exposure weighted averages have been weighted by the sum of EAD within each of the PD bands.
- (4) Undrawn commitments are defined as the difference between the drawn balance and the limit.
- (5) Undrawn weighted average CCF has been weighted by the sum of undrawn commitments within each of the PD bands.

Key points

- The reduction in EAD within AQ6 to 10 is due to the natural run-off of the unsecured lending exposures, driven by risk appetite considerations.
- Declines in EAD's and RWA's are due to a significant reduction of the personal loan portfolio. This trend was consistent with the expectations/forecast for 2010.

Credit risk continued

IRB exposures covered by guarantees and credit derivatives

The Group utilises a number of different types of collateral. The following table details the total advanced IRB exposure covered by guarantees and credit derivatives. However, this only represents certain elements of collateral taken into consideration by the Group when calculating RWAs. For other types of collateral taken, refer to the credit risk section.

Table 20: Advanced IRB exposure covered by guarantees and credit derivatives

	2010	2009
Advanced IRB exposure class (1,2)	£m	£m
Central governments and central banks	481	5
Institutions	227	23
Corporates	14,074	8,883
Non-credit obligation assets	25	29
Securitisation position	10	—
	14,817	8,940

Notes:

- (1) Exposures covered by guarantees and credit derivatives represent the value of the guarantee or credit derivatives, but capped at the value of the associated EAD post CRM of the facility. Guarantees disclosed do not include parental guarantees where the PD substitution approach is applied.
- (2) Excludes tranching credit protection purchased for capital management purposes.

Key point

- RBS N.V. transition accounted for a £6.6 billion increase in guarantees and credit derivatives through parental guarantees and credit default swaps (CDS). This is partially offset by the roll-off of tranching relief trades, and exposure reductions through Non-Core asset disposals in the corporate exposure class.

Credit risk continued

Expected loss and impairment

Expected loss is the loss forecast over a one year time horizon as a result of applying the Group's PD, LGD and EAD models to its portfolios. Across its portfolios, the Group's PD models incorporate differing degrees of through-the-cycle and point-in-time characteristics. LGD and EAD reflect downturn economic conditions. Table 21, below, shows the expected loss at 31 December 2009 and 2008.

The impairment charge for the year following the forecast expected loss are also shown in the table below. Impairment charge is the amount taken to the income statement during the year in respect of defaulted assets.

There exist material differences between the methodologies and underlying principles for calculating expected loss according to regulatory requirements and for raising impairments under accounting standards. Notable among these differences are:

- **Timing:** for the period after default and before write-off of an asset, an expected loss according to regulatory requirements will continue to be calculated while some or all of the associated actual impairment loss may already have been taken to the income statement.

- **Cyclicality:** for PD models with dominant through-the-cycle characteristics (notably wholesale models), expected loss will not, by definition, produce a result that aligns with actual loss experience in every one year period.

Any comparison between these two sets of data must therefore take into consideration these key differences.

Impairment charges for 2010 exhibited some fluctuations; however, the largest contributor was Ulster Banks' Corporate portfolio where losses in the Irish housing markets continued to weigh on results and profitability. Further details of the impairment charge are shown on page 239 to 249 of the Groups 2010 Annual Report and Accounts.

On a statutory basis total impairment losses for the year ended 2010 were £9,256 million of which £8,061 million relates to advanced IRB exposures excluding RBS N.V., as detailed below.

Table 21: Expected loss and impairment charge

	Expected loss 2009 £m	Impairment charge 2010 £m	Expected loss 2008 £m	Impairment charge 2009 £m
Advanced IRB exposure class	£m	£m	£m	£m
Central governments and central banks	2	-	2	-
Institutions	71	-	38	-
Corporates	13,384	6,252	4,753	7,760
Retail SME	1,454	258	1,313	371
Retail secured by real estate collateral	564	513	346	240
Qualifying revolving retail exposure	1,593	535	1,322	913
Other retail exposures	2,190	503	2,060	713
Equities	31	-	28	-
	19,289	8,061	9,862	9,997

Key points

- The increase in expected loss of £9.4 billion is mainly due to a significant increase in the stock of defaulted assets in the commercial and residential property sectors in the UK, US, Spain and Ireland. A significant proportion of these defaults were in the property, technology media and telecommunications, wholesale and retail trading, and financial institutions sectors
- The provision balance at 31 December 2010 was £18.2 billion, disclosures on which are shown on pages 70 to 72.
- The majority of RBS N.V. assets were migrated to the advanced IRB approach during 2010. As the disclosure relates to a one year outcome and as RBS N.V. assets were on an advanced IRB approach for only a portion of the year, RBS N.V. is not included in tables 21 and 22 and will be included for the first time in the 2011 disclosure showing predictions at 31 December 2010 and 2011 outcomes.

Credit risk continued

Probability of default (PD)

Wholesale credit grading models are hybrid models where the PD has been calibrated to each grade using historic data, and are expected to remain stable in their mapping to each grade over a cycle. However, the grade assignments to individual customers take into account current economic conditions and the customer's credit quality. The customer grade is therefore expected to change over a cycle.

Retail PD models are targeted to be point in time methodologies to facilitate pricing, setting of risk appetite and loss estimation. Models

are regularly calibrated to produce robust estimates incorporating a degree of conservatism.

The following table details the PD estimated at the beginning of the past two reporting periods, compared with actual default rates experienced during the reporting periods. PD is the average counterparty PD for wholesale exposures and the average account level PD for retail exposures. Exposures in default at the start of the period are excluded since the probability of default is 100%. The default rate is the number of defaults observed during the year divided by the number of obligors or accounts at the start of the period.

Table 22: Predicted probability of default and actual default rates

	Probability of default 2009 %	Actual defaults 2010 %	Probability of default 2008 %	Actual defaults 2009 %
Advanced IRB exposure class				
Central governments and central banks	0.31	-	0.39	-
Institutions	0.44	-	0.53	-
Corporates	2.53	5.63	1.99	6.28
Retail SME	5.57	3.95	4.76	4.46
Retail secured by real estate collateral	2.04	1.91	1.41	1.79
Qualifying revolving retail exposure	2.82	2.37	2.49	2.86
Other retail exposures	6.05	5.24	4.95	6.65
Equities	2.28	0.98	3.19	2.76

Key points

- In the corporate exposure class, the increasing PD largely reflects adverse credit migration in 2009.
- Across the retail portfolios, the increasing PD reflects the recalibration of models in light of cyclical default experience.
- Across all portfolios, with the exception of Ulster Bank, these trends have stabilised since the 31 December 2009 observation point.
- The trends in actual default rates reflect this improvement. The exception is retail secured by real estate collateral where the default rate was higher in 2010, attributable mainly to the Ulster mortgage portfolio.

Credit risk continued

Credit risk by standardised approach

Several of the Group's portfolios are currently managed under the standardised approach, including:

- *US Retail & Commercial*: retained on standardised for FSA reporting, pending migration to the IRB approach (with migration dependent on the Basel II timetable in the United States).
- *Wealth*: given the low level of loss experience, the FSA has approved the use of standardised in all cases, as required by BIPRU.
- *RBS N.V.*: pending final transition of remaining exposures to advanced IRB approach, and portfolios targeted for disposal.

Exposures are allocated to specific standardised exposure classes as determined by the FSA's BIPRU 3 and it is these classes that determine the risk-weight used. For exposures to corporates, sovereigns and institutions, the Group uses the external credit assessments of recognised credit rating agencies (Moody's, Standard & Poor's and Fitch, as appropriate). All other exposures are unrated with the risk-weights determined by the BIPRU rules.

The Group's RWAs and capital requirements by standardised exposure class are detailed in the following table. The balances include non-customer and intra-group assets.

Table 23: RWAs and capital requirements by standardised exposure class

Standardised exposure class	2010		2009	
	Credit RWAs post CRM £m	Minimum capital requirement £m	Credit RWAs post CRM £m	Minimum capital requirement £m
Central governments and central banks	336	27	10	1
Regional governments and local authorities	211	17	22	2
Administrative bodies and non-commercial undertakings	53	4	70	6
Institutions (1)	764	61	673	54
Corporates (1)	59,690	4,775	46,162	3,693
Retail	24,945	1,996	25,531	2,042
Secured by real estate property	5,067	405	4,653	372
Past due items	2,445	196	2,071	165
Securitisation positions	5,314	425	9,801	784
Collective investment undertakings	-	-	8	1
Other items (2)	16,227	1,298	10,975	878
	115,052	9,204	99,976	7,998

Notes:

(1) Includes intra-group assets under exposure classes corporates and institutions.

(2) Includes non-customer assets.

Key point

- The 15% increase in standardised RWAs was mostly due to the RBS N.V. transition under the Group's Basel II advanced IRB waiver. This waiver designated several legacy ABN AMRO portfolios for the Basel II standardised approach and is the principal reason for the increase in the corporate exposure class.

Credit risk continued

Gross standardised customer credit risk

The following tables detail the Group's gross standardised customer credit risks by exposure class, geographic area, industry sector, and residual maturity band. The gross customer exposure is shown before the application of CRM and excludes products calculated under the counterparty credit risk approach (CCR).

Table 24: Standardised gross exposure by exposure class

Standardised exposure class	2010 (1,2)		2009 (1,2)	
	Exposure pre CRM £m	Average exposure pre CRM (3) £m	Exposure pre CRM £m	Average exposure pre CRM (3) £m
Central governments and central banks	34,854	47,453	59,981	25,219
Regional governments and local authorities	4,262	2,640	132	130
Administrative bodies and non-commercial undertakings	175	200	228	278
Multilateral development banks	31	254	295	278
Institutions	2,601	2,779	2,567	2,348
Corporates	60,638	58,198	51,401	57,028
Retail	38,050	40,443	39,671	42,881
Secured by real estate property	14,756	14,835	13,633	14,789
Past due items	1,801	1,829	1,542	1,370
Securitisation positions	1,888	2,191	2,420	1,903
Collective investment undertakings	-	3	16	21
Other items (4)	1,146	1,171	1,131	3,892
	160,202	171,996	173,017	150,137

Notes:

- (1) Exposure pre CRM is before the application of on-balance sheet netting and financial collateral.
- (2) Exposure excludes intra-group and non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) Average is based on the full year.
- (4) Other items include customer assets only.
- (5) An additional EAD of £3,048 billion relating to consortium partners share from the RBS N.V. transition is not included in the EAD analysed in the tables that follow.

Key points

- The 42% decline in central governments and central banks was due to the maturing of bond exposures and placements with the UK Government. This combined with a shift of North American central bank exposures from the Basel II standardised to advanced IRB method.
- The increase in regional governments and corporates was due to the RBS N.V. transition from Basel I to Basel II standardised.

Credit risk continued

Table 25: Standardised gross exposure by geographic area

Standardised exposure class	UK £m	North America £m	Western Europe (excl.UK) £m	Asia Pacific £m	Latin America £m	CEE Central Asia £m	Middle East and Africa £m	Total £m
2010 (1,2,3)								
Central governments and central banks	25,327	7,709	838	407	14	559	-	34,854
Regional governments or local authorities	27	113	3,975	-	-	147	-	4,262
Administrative bodies and non-commercial undertakings	1	174	-	-	-	-	-	175
Multilateral development banks	-	-	31	-	-	-	-	31
Institutions	201	395	1,513	459	6	25	2	2,601
Corporates	14,061	36,268	4,773	1,908	2,750	609	269	60,638
Retail	6,718	29,141	1,162	493	202	277	57	38,050
Secured by real estate property	6,787	5,980	789	856	75	207	62	14,756
Past due items	529	896	289	32	1	53	1	1,801
Securitisation positions	37	1,851	-	-	-	-	-	1,888
Other items (4)	247	899	-	-	-	-	-	1,146
	53,935	83,426	13,370	4,155	3,048	1,877	391	160,202
2009 (1,2,3)								
Central governments and central banks	34,082	18,804	6,757	335	-	-	3	59,981
Regional governments or local authorities	10	122	-	-	-	-	-	132
Administrative bodies and non-commercial undertakings	1	227	-	-	-	-	-	228
Multilateral development banks	-	-	295	-	-	-	-	295
Institutions	181	689	1,270	369	55	1	2	2,567
Corporates	12,321	36,752	522	531	1,144	36	95	51,401
Retail	6,841	31,208	1,100	228	199	31	64	39,671
Secured by real estate property	5,532	7,054	550	397	12	21	67	13,633
Past due items	398	986	157	-	-	-	1	1,542
Securitisation positions	43	2,377	-	-	-	-	-	2,420
Collective investment undertakings	16	-	-	-	-	-	-	16
Other items (4)	215	916	-	-	-	-	-	1,131
	59,640	99,135	10,651	1,860	1,410	89	232	173,017

Notes:

- (1) Exposure pre CRM is before the application of on-balance sheet netting and financial collateral.
- (2) Exposure excludes intra-group and non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) The geographic area is determined by the country of incorporation for companies and for individuals as the country of residence.
- (4) Other items include customer assets only.

Key points

- The decrease of £5.7 billion in United Kingdom was due to a decline in central governments and central banks as government bond exposures matured and were rolled-off, offset by an increase in corporates and secured by real estate exposures attributable to the transition of RBS N.V. to the standardised approach.
- The decline of £15.7 billion in North America was partly due to a change in methodology where certain exposures were transitioned to the Basel II advanced IRB methodology.
- The increase in Western Europe (£2.7 billion) is principally attributable to German regional governments exposures within RBS N.V..

Credit risk continued

Table 26: Standardised gross exposure by industry sector

Sector cluster	Central governments and central banks £m	Regional governments or local authorities £m	Administrative bodies and non-commercial undertakings £m	Multilateral development banks £m	Institutions £m	Corporates £m	Retail £m	Secured by real estate property £m	Past due items £m	Securitisation positions £m	Other items(4) £m	Total £m
2010 (1,2,3)												
Banks	-	-	-	31	2,596	87	5	-	1	226	470	3,416
Insurers and funds	-	-	-	-	-	3,330	37	-	6	-	10	3,383
Manufacturing (cyclical)	-	-	-	-	-	3,921	65	1	7	-	1	3,995
Manufacturing (non-cyclical)	-	-	-	-	-	2,273	93	3	34	-	-	2,403
Natural resources	-	-	-	-	-	3,276	24	-	32	-	-	3,332
Non-bank financial institutions	4,182	-	26	-	1	7,989	105	416	53	1,262	113	14,147
Personal	-	-	-	-	-	1,499	33,493	14,050	749	-	-	49,791
Property	-	13	-	-	-	9,892	274	24	626	-	247	11,076
Retail and leisure	-	-	2	-	-	11,545	2,767	56	234	-	-	14,604
Securitisations	-	-	-	-	-	4,498	-	-	1	386	-	4,885
Services	2	40	54	-	-	7,751	1,001	205	33	-	-	9,086
Sovereigns and quasi sovereigns	30,670	4,209	93	-	4	182	11	-	-	14	302	35,485
Technology, media and telecommunications	-	-	-	-	-	1,795	33	-	8	-	3	1,839
Transport	-	-	-	-	-	2,600	142	1	17	-	-	2,760
	34,854	4,262	175	31	2,601	60,638	38,050	14,756	1,801	1,888	1,146	160,202

For the notes and key points refer to page 43.

Credit risk continued

Table 26: Standardised gross exposure by industry sector (continued)

Sector cluster	Central governments and central banks	Regional governments or local authorities	Administrative bodies and non-commercial undertakings	Multilateral development banks	Institutions	Corporates	Retail	Secured by real estate property	Past due items	Securitisation positions	Collective investment undertakings	Other items(4)	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2009 (1,2,3)													
Banks	311	-	-	295	2,435	397	4	-	1	442	-	488	4,373
Insurers and funds	-	-	-	-	42	2,677	75	1	31	74	16	21	2,937
Manufacturing (cyclical)	-	-	-	-	-	3,288	46	-	9	-	-	1	3,344
Manufacturing (non-cyclical)	-	-	-	-	-	1,498	82	2	9	-	-	-	1,591
Natural resources	-	-	-	-	-	2,173	29	-	20	-	-	-	2,222
Non-bank financial institutions	5,886	-	31	-	64	9,332	124	434	62	1,881	-	126	17,940
Personal	-	-	-	-	-	1,422	33,553	12,886	769	-	-	197	48,827
Property	-	-	-	-	-	9,186	230	41	208	-	-	2	9,667
Retail and leisure	-	-	-	-	-	8,217	3,948	64	222	-	-	1	12,452
Services	1	39	93	-	-	9,280	1,384	204	180	-	-	2	11,183
Sovereigns and quasi sovereigns	53,783	93	104	-	26	161	11	-	3	23	-	289	54,493
Technology, media and telecommunications	-	-	-	-	-	1,115	17	-	6	-	-	4	1,142
Transport	-	-	-	-	-	2,655	168	1	22	-	-	-	2,846
	59,981	132	228	295	2,567	51,401	39,671	13,633	1,542	2,420	16	1,131	173,017

Notes:

- (1) Exposure pre CRM is before the application of on balance sheet netting and financial collateral.
- (2) Exposure excludes intra-group and non-customer assets along with OTC and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) The Group has implemented a new mapping of exposure from underlying SIC to sector cluster within 2010. This mapping has been applied against the 2009 SIC population to achieve a consistent comparison. In addition, new SIC were introduced during 2010 to facilitate improved portfolio management (most notably the introduction of the securitisations sector cluster, resulting in a migration of relevant exposure from non-bank financial institutions to securitisations).
- (4) Other items include customer assets only.

Key points

- Total exposure has decreased by £12.9 billion principally reflecting transitions of certain exposures to the advanced IRB approach, and business disposals.
- The largest reduction in core exposure within the sovereigns and quasi sovereigns sector was driven by the maturing of liquidity placements and bond purchases with UK central governments and central banks counterparties, and the transfer of exposures from the Basel II standardised to the advanced IRB approach.
- This was offset by the inclusion of certain credit exposures totalling £10.9 billion held within RBS N.V., following the transition of certain exposures to the Basel II standardised approach.

Credit risk continued

Table 27: Standardised gross exposure by residual maturity

Standardised exposure class	Within 1 year (5) £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
2010 (1,2,3)				
Central governments and central banks	19,056	6,662	9,136	34,854
Regional governments or local authorities	919	2,273	1,070	4,262
Administrative bodies and non-commercial undertakings	57	66	52	175
Multilateral development banks	-	31	-	31
Institutions	2,407	188	6	2,601
Corporates	17,173	30,975	12,490	60,638
Retail	4,366	13,308	20,376	38,050
Secured by real estate property	872	3,626	10,258	14,756
Past due items	404	771	626	1,801
Securitisation positions	-	-	1,888	1,888
Other items (4)	-	-	1,146	1,146
	45,254	57,900	57,048	160,202
2009 (1,2,3)				
Central governments and central banks	16,374	30,294	13,313	59,981
Regional governments or local authorities	53	57	22	132
Administrative bodies and non-commercial undertakings	48	108	72	228
Multilateral development banks	91	71	133	295
Institutions	2,210	356	1	2,567
Corporates	14,700	22,711	13,990	51,401
Retail	4,002	15,170	20,499	39,671
Secured by real estate property	718	2,423	10,492	13,633
Past due items	454	519	569	1,542
Securitisation positions	-	-	2,420	2,420
Collective investment undertakings	-	-	16	16
Other items (4)	-	215	916	1,131
	38,650	71,924	62,443	173,017

Notes:

- (1) Exposure pre credit risk mitigation is before the application of on-balance sheet netting and financial collateral.
- (2) Exposure excludes intra-group, non-customer assets, OTC derivatives and repo products which are shown separately in the counterparty credit risk disclosures.
- (3) Maturity bands represent the residual contractual maturity.
- (4) Other items include customer assets only.
- (5) Revolving facilities are included in the 'within 1 year' category.

Key points

- The largest reduction in exposure was within maturities after 1 year but within to 5 years. This was driven by a combination of maturing liquidity placements with UK sovereigns and the migration of certain exposures from the Basel II standardised to the advanced IRB approach. There was also a reduction in North American home equity and personal loans portfolios within the retail exposure class. Further reductions in exposure with maturities greater than 5 years was driven by reduced bond exposure to UK and US based central governments and banks.
- Underlying RBS N.V. exposures under the standardised approach are concentrated within the regional governments or local authorities and corporates exposure classes and have also been managed down across most maturities through run-off as well as business disposals.

Credit risk continued

Standard exposures are shown below by credit quality steps. Internal ratings (i.e. AQ bands) are not applicable to the standardised portfolio. The mappings between the main external credit assessment institutions used by the Group and the credit quality steps used to determine the risk-weight is detailed in the following table. Where no external rating is used in the RWA calculation, the unrated credit quality step applies.

Table 28: Credit quality steps mapping to external credit gradings

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

Credit risk continued

The standardised portfolio exposure by the credit quality steps (CQS) is detailed in the table below. EAD is exclusive of exposures calculated under the counterparty credit risk approaches.

Table 29: Standardised portfolio exposure for customer credit risk and counterparty credit risk by credit quality steps

Standardised exposure class 2010 (1,2)	Credit quality step						Unrated exposure £m	Total £m
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m		
Central governments and central banks (3)								
Exposure pre CRM	34,124	1	449	-	14	-	266	34,854
Exposure post CRM	34,124	1	449	-	14	-	266	34,854
Regional governments or local authorities								
Exposure pre CRM	4,070	18	9	136	-	-	30	4,263
Exposure post CRM	4,070	18	9	136	-	-	30	4,263
Administration bodies and non-commercial undertakings								
Exposure pre CRM	132	20	-	22	-	-	1	175
Exposure post CRM	132	20	-	22	-	-	1	175
Multilateral development banks								
Exposure pre CRM	31	-	-	-	-	-	-	31
Exposure post CRM	31	-	-	-	-	-	-	31
Institutions								
Exposure pre CRM	1,101	702	38	4	3	-	753	2,601
Exposure post CRM	1,101	702	38	4	3	-	753	2,601
Corporates								
Exposure pre CRM	6,687	775	1,511	980	591	142	49,951	60,637
Exposure post CRM	6,687	775	1,511	980	591	142	48,446	59,132
Retail								
Exposure pre CRM	-	-	-	-	-	-	38,050	38,050
Exposure post CRM	-	-	-	-	-	-	37,656	37,656
Secured by real estate property								
Exposure pre CRM	-	-	-	-	-	-	14,756	14,756
Exposure post CRM	-	-	-	-	-	-	14,756	14,756
Past due items								
Exposure pre CRM	-	-	-	-	30	-	1,771	1,801
Exposure post CRM	-	-	-	-	30	-	1,761	1,791
Securitisation positions								
Exposure pre CRM	789	25	17	87	970	-	-	1,888
Exposure post CRM	789	25	17	87	970	-	-	1,888
Other items (4)								
Exposure pre CRM	464	2	-	-	-	-	680	1,146
Exposure post CRM	464	2	-	-	-	-	680	1,146
Total exposure pre CRM	47,398	1,543	2,024	1,229	1,608	142	106,258	160,202
Total exposure post CRM	47,398	1,543	2,024	1,229	1,608	142	104,349	158,293

Notes:

- (1) The credit quality steps (CQS) are a combination of the counterparty exposure class and the external rating applied. Where no external rating is used in the RWA calculation a credit quality step of unrated is shown. For the mapping of credit quality steps to external ratings refer to table 28.
- (2) Exposure excludes intra-group and non-customer assets.
- (3) A combination of all three agency ratings was used for central governments and central banks. Unrated relates to exposures where the obligor or issue was not rated. However, these exposures may still receive a zero risk weight (CQS1), where BIPRU rules allow inference of risk weight from an equivalent sovereign or issuer.
- (4) Other items include customer assets only.

Credit risk continued

Table 29: Standardised portfolio exposure for customer credit risk and counterparty credit risk by credit quality steps (continued)

Standardised exposure class 2009 (1,2)	Credit step quality						Unrated exposure £m	Total £m
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m		
Central governments and central banks (3)								
Exposure pre CRM	59,917	3	-	-	-	-	61	59,981
Exposure post CRM	59,917	3	-	-	-	-	60	59,980
Regional governments or local authorities								
Exposure pre CRM	122	-	-	-	-	-	10	132
Exposure post CRM	122	-	-	-	-	-	10	132
Administration bodies and non-commercial undertakings								
Exposure pre CRM	197	-	-	-	-	-	31	228
Exposure post CRM	195	-	-	-	-	-	31	226
Multilateral development banks								
Exposure pre CRM	295	-	-	-	-	-	-	295
Exposure post CRM	295	-	-	-	-	-	-	295
Institutions								
Exposure pre CRM	1,318	282	26	54	-	-	887	2,567
Exposure post CRM	1,318	282	26	54	-	-	887	2,567
Corporates								
Exposure pre CRM	8,023	281	642	286	364	218	41,587	51,401
Exposure post CRM	8,023	281	642	286	364	218	40,624	50,438
Retail								
Exposure pre CRM	-	-	-	-	-	-	39,671	39,671
Exposure post CRM	-	-	-	-	-	-	39,293	39,293
Secured by real estate property								
Exposure pre CRM	-	-	-	-	-	-	13,633	13,633
Exposure post CRM	-	-	-	-	-	-	13,633	13,633
Past due items								
Exposure pre CRM	-	-	-	-	-	-	1,542	1,542
Exposure post CRM	-	-	-	-	-	-	1,539	1,539
Securitisation positions								
Exposure pre CRM	1,028	106	418	192	676	-	-	2,420
Exposure post CRM	1,028	106	418	192	676	-	-	2,420
Collective investment undertakings								
Exposure pre CRM	-	-	-	-	-	-	16	16
Exposure post CRM	-	-	-	-	-	-	16	16
Other items (4)								
Exposure pre CRM	483	1	-	-	-	-	647	1,131
Exposure post CRM	483	1	-	-	-	-	647	1,131
Total exposure pre CRM	71,383	673	1,086	532	1,040	218	98,085	173,017
Total exposure post CRM	71,381	673	1,086	532	1,040	218	96,740	171,670

Key points

- Reductions in UK Sovereign exposures in conjunction with a transfer of US exposures to the Basel II advanced IRB approach was the primary reason behind the exposure reductions seen in CQS1. Other notable increases in CQS3 are from the Sovereigns of Romania and Kazakhstan - held by the RBS N.V.. Exposure increases in local authorities/municipalities are also related to RBS N.V., where £4 billion of the increase in CQS1 relates to exposures with German states and regional governments.
- An increase was observed in corporates' unrated exposures, and was attributable to the recognition of underlying assets for special purpose vehicles that have failed significant risk transfer as a result of recent regulatory changes. These assets were previously booked under advanced IRB securitisation positions. The increase in unrated, is also due to the inclusion of RBS N.V. assets that are in transition to advanced IRB models, as their legacy models are currently undergoing re-development.
- The sale of US Government guaranteed student loan portfolios in combination with the disposal of the Non-Core credit card business drove a reduction in retail exposures. This was partially offset by an increase in Asian and Latin American Non-Core retail and commercial banking assets held for disposal.
- Of the £38 billion in retail exposures (EAD Pre CRM), approximately 51% (£19.3 billion) are not recognised as being fully secured by residential mortgages under the regulatory interpretation of "Secured on Real Estate". However, they are secured by 1st or 2nd lien mortgages. In addition a further 13.6% (£5.2 billion) are secured by other physical collateral such as automobiles or marine assets.

Credit risk *continued*

Table 30: Standardised exposures covered by eligible financial collateral

Standardised exposure class (1)	2010 £m	2009 £m
Corporates	2,315	965
Retail	408	384
Past due items	-	3
Administrative bodies and non-commercial undertakings	-	1
	2,723	1,353

Note:

(1) Exposure covered by eligible financial collateral represents the value of financial collateral applied in the credit RWA calculation after volatility adjustments.

Key points

- The devaluation of sterling against the US Dollar and Swiss Franc year-on-year has led to an increase in the value of collateral denominated in those currencies.
- The increase in corporate exposures was partly as a result of the RBS N.V. transition and a temporary reclassification of a structured finance portfolio to standardised from the advanced IRB methodology.

Table 31: Standardised exposures covered by guarantees and credit derivatives

Standardised exposure class (1)	2010 £m	2009 £m
Central governments and central banks	4,554	5,940
Regional governments and local authorities	6	-
Institutions	1	-
Corporates	43	17
Retail	743	1,197
Secured on real estate property	689	885
Securitisation positions	644	-
Past due items	18	17
	6,698	8,056

Note:

(1) Exposure covered by guarantees and credit derivatives represents the value of the guarantees and credit derivatives applied in the credit RWA calculation.

Key points

- The decline in central governments and banks was due to a decline in exposures guaranteed by the US Government principally in fixed and floating rate Government National Mortgage Association securities.
- The decline in Retail principally reflects sales of US government guaranteed student loans. The remaining portfolio is now in run-off in line with the Group's risk appetite due to regulatory changes over student finance guarantees.
- The increase in securitisation positions is wholly attributable to the purchase of credit default swap protection for the North American residential mortgage backed securities portfolio as part of the Group's capital management strategy.

Credit risk *continued*

Credit risk – RBS N.V.

In 2010 RBS NV moved to a Basel II basis and is now included in the relevant advanced IRB or standardised disclosures. The table below sets out the comparative data for RBS N.V. on a Basel I basis.

Table 32: RBS N.V. credit RWAs and minimum capital requirements

Standardised exposure class	2009		Minimum capital requirement £m
	Exposure £m	Credit RWAs £m	
Central governments and central banks	78,148	1,081	86
Institutions	18,649	10,539	843
Corporates	161,815	108,534	8,683
Retail	8,380	15,511	1,241
Secured by real estate property	84,701	18,857	1,509
Other	41,506	8,636	691
Securitisation	395	76	6
	393,594	163,234	13,059

Counterparty credit risk

Counterparty credit risk (CCR) is the risk that a counterparty defaults prior to the maturity of a derivative contract. The risk may result from derivative transactions in either the trading or banking book and is covered by a credit risk framework consistent with other exposures. A number of specific policies govern how the Group manages such risk i.e. documentation requirements, product-specific requirements (e.g., equity/futures and securities lending), counterparty-specific

requirements (e.g. hedge funds, pension funds), issuer risk policy, margin trading policy, collateral acceptability and custodians.

The following tables detail the total counterparty credit risk capital component and the current counterparty credit risk exposure, post credit risk mitigation by product type.

Table 33: Counterparty credit risk capital requirement

	Minimum capital requirement 2010 £m	Minimum capital requirement 2009 £m
Counterparty credit risk capital component	5,451	4,517

Table 34: Counterparty credit risk exposure

Product type	EAD post CRM 2010 £m	EAD post CRM 2009 £m
OTC derivatives	115,100	111,471
Repos	41,223	50,937
	156,323	162,408

Counterparty credit limit setting

Once commercial support/sponsorship is confirmed, counterparty credit limits are established through the Group's credit approval framework. Limits are established based on the credit quality of the counterparty and the projected maximum potential future exposure of anticipated derivative transactions, based on 95th percentile assumptions. Credit limits are set by product and reflect documentation held for netting or collateral management purposes.

For external capital purposes, some counterparty risk is calculated using expected positive exposure methodology. It is expected that over time additional derivative exposures, not currently measured under the expected positive exposure methodology, will also be captured in this way. The Group uses 1.6 alpha which forms part of the exposure calculation to convert the effective positive exposure to an exposure value.

Outstanding exposures are calculated as the mark to market position of outstanding contracts plus an additional potential future exposure based on the transactions' characteristics and governing documentation.

The following table details EAD by method.

Table 35: Counterparty credit risk exposure at default by method

Method	EAD post CRM 2010 £m	EAD post CRM 2009 £m
CCR mark-to-market	105,160	112,633
Expected positive exposure	40,317	34,492
Value-at-risk	10,846	15,283
	156,323	162,408

Key points

- The decline of EAD under the mark-to-market method is mainly due to the expiration of several repo-style transactions with sovereign and financial institution counterparties.
- The strengthening of USD, Yen and Swiss Franc against GBP were a key factor in the increase in the value of exposures under the expected positive exposure method.
- The drop in exposures under the VaR method was due to the redemption of several Bank of England short-term repo trades, and the maturity of repos with institutional counterparties.

Counterparty credit risk continued

Counterparty risk mitigation

To mitigate counterparty credit risk, it is Group policy to execute netting and collateral agreements where legally enforceable. Additionally, dynamic credit risk reserving, as explained under CVAs below, is adopted as a further discipline to manage counterparty credit risk.

Netting and collateralisation

It is Group policy to ensure that appropriate swaps and derivative documentation is executed for clients prior to trading. Exceptions to this require specific approval from a senior risk officer. A formal documentation policy governs all derivative counterparties deemed

suitable in terms of their legal and administrative capacity to enter into collateral agreements. Where netting and/or collateral enforceability criteria are not fulfilled, exposure is assumed to be uncollateralised. The policy framework establishes minimum documentation requirements and preferred credit terms under collateral agreements including: unsecured thresholds; minimum transfer amounts; independent amounts; minimum haircuts; collateral eligibility criteria, and collateral call frequency. The framework also includes a formal escalation process for counterparty collateral disputes and unpaid collateral calls.

The risk mitigating impact of netting and collateralisation on counterparty credit risk for derivatives under the mark-to-market approach only is detailed in the following table.

Table 36: Netting and collateralisation impact to counterparty credit risk

Counterparty credit risk	2010 £m	2009 £m
Gross positive fair value of contracts plus potential future credit exposure	260,695	285,346
Netting benefits	(168,013)	(189,139)
Net current credit exposure plus potential future credit exposure	92,682	96,207
Collateral held	(17,899)	(19,228)
Exposure at default post CRM	74,783	76,979

Key point

- The disposal of RBS Sempra Metals, Oil, European Energy and North American Power and Gas business lines to JP Morgan accounted for a £2.7 billion decline in EAD. This was, however, offset by the weakening of sterling relative to other major trading currencies primarily Yen and USD.

On a daily basis, for treasury and liquidity management purposes, the Group calculates its additional requirements to post collateral by counterparty and, in aggregate, upon a one and two notch downgrade in its external credit rating.

Credit valuation adjustments

Credit valuation adjustments (CVAs) represent an estimate of the adjustment to the fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures. CVAs for monoline insurance companies are calculated on a trade by trade basis, using market observable credit spreads. The methodology used for credit derivative product companies is similar albeit, in the absence of market observable credit spreads it estimates the cost of hedging expected default losses in excess of the capital available in each vehicle. For all other counterparties CVA is calculated either on a trade by trade basis reflecting the estimated cost of hedging the risk through

credit derivatives, or on a portfolio basis reflecting an estimate of the amount the third party would have to pay to assume the risk.

Credit derivatives

As part of its credit risk strategy to mitigate portfolio risk concentrations, the Group buys credit derivative products from market counterparties which incur counterparty credit risk. Such counterparties are subject to the Group's standard credit risk analysis criteria. Over and above this, additional restrictions apply with respect to eligibility and suitability, (e.g. credit protection bought from the same corporate group as the reference entity is not considered eligible credit protection). A summary of notional credit derivative products is detailed in the table below, split between protection bought for portfolio management purposes and that relating to intermediation in the credit derivative markets.

Counterparty credit risk *continued*

Table 37: Credit derivative transactions

	31 December 2010		31 December 2009	
	Credit default swaps	Total return swaps	Credit default swaps	Total return swaps
Notional principal amount of credit derivative transactions	£m	£m	£m	£m
Used for own credit portfolio – protection bought	14,036	-	37,906	350
Used for intermediation activities – protection bought	572,171	820	652,021	8,946
Used for intermediation activities – protection sold	548,170	290	625,332	4,350
	1,134,377	1,110	1,315,259	13,646

Key points

- The drop in credit derivatives used for own portfolio protection was due to an unwinding of several credit default swaps (CDS) trades protecting securitisation positions.
- The decline in bought CDS used for intermediation was attributable to an overall drop in demand for credit protection, driven by a significant drop in the value of single name CDS. Offsetting this was an increase in tranching Nth-to-default basket CDS.
- The declines in sold protection used for intermediation was also reflective of the diminished appetite for credit derivative products as seen in the declines in single-name CDS and tranching Nth-to-Default basket products.

Management of negative risk correlations

The Group has a formal risk framework governing negative risk correlations or wrong way risks. Wrong way risks arise when the risk factors driving the exposure to a counterparty are adversely correlated with the credit quality of that counterparty. There is a tendency for the exposure to increase as the creditworthiness decreases.

This framework:

- defines the three different types of wrong way risks;
- identifies scenarios whereby the Group may be exposed to this risk;
- establishes the credit treatment;
- proposes mechanisms of control and monitoring by implementing reporting and escalation processes; and
- recommends risk mitigants.

Securitisation

Objectives, roles and involvement

The Group arranges securitisations to facilitate third party clients, to sell financial assets or to fund specific portfolios of assets. The Group also acts as an underwriter and depositor in securitisation transactions involving both client and proprietary transactions.

Special purpose entities (SPE), vehicles set up for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms e.g. trusts, partnerships and companies, and fulfil many different functions. As well as being a key element of securitisations, SPEs are also used in fund management activities to segregate custodial duties from the fund management advice provided by the Group.

Securitisations may, depending on the individual arrangement, result in continued recognition of the securitised assets; continued recognition of the assets to the extent of the Group's continuing involvement in those assets; or derecognition of the assets and the separate recognition, as assets or liabilities, of any rights and obligations created or retained in the transfer (see accounting policy in the 2010 Annual Report and Accounts). The Group has securitisations in each of these categories. The regulatory treatment may differ from the accounting treatment.

For the purpose of these disclosures:

- *Traditional securitisations*: are defined as where an originating bank transfers a pool of assets that it owns to an arm's length special purpose entity.
- *Synthetic securitisations*: are defined as where the originating bank transfers only the credit risk associated with an underlying pool of assets through the use of credit linked notes or credit derivatives, whilst retaining legal ownership of the pool of assets.

The Group's objectives in relation to securitisation activity are as follows:

- increase the availability of different sources of funding;
- diversify the funding the Group uses;
- facilitate prudential balance sheet management; and
- earn management fees on assets under management.

The types of transactions entered into by the Group are as follows:

- *residential mortgage securitisations*: the Group has securitised portfolios of residential mortgages. Mortgages have been transferred to special purpose entities, held ultimately by charitable trusts and funded principally through the issue of floating rate notes. The Group has entered into arm's length fixed/floating interest rate swaps and cross-currency swaps with the securitisation special purpose entities, and provides mortgage management and agency services to them. On repayment of the financing, any further amounts generated by the mortgages will be paid to the Group. The special purpose entities are consolidated for accounting purposes and the mortgages remain on the Group's balance sheet;
- *credit card securitisations*: credit card receivables in the UK have been securitised with notes that have been issued by special purpose entities. The note holders have a proportionate interest in a pool of credit card receivables that have been equitably assigned by the Group to a receivables trust. The Group continues to receive excess spread (after charge-offs), and so the special purpose entities are consolidated for accounting purposes and the credit card receivables remain on the Group's balance sheet;
- *other securitisations*: other loans originated by the Group have been transferred to special purpose entities, funded through the issue of notes. Any proceeds from the loans in excess of the amounts required to service and repay the notes, are payable to the Group after deduction of expenses. The special purpose entities are consolidated for accounting purposes and the loans remain on the Group's balance sheet;
- *commercial paper conduits*: the Group sponsors commercial paper conduits. Customer assets are transferred into special purpose entities which issue notes in the commercial paper market. The Group supplies certain services and contingent liquidity support to these special purpose entities on an arm's length basis as well as programme credit enhancement. The special purpose entities are consolidated for accounting purposes; and
- *finance lease receivables*: certain finance lease receivables (leveraged leases) in the US involve the Group as lessor obtaining non-recourse funding from third parties. This financing is secured on the underlying leases and the provider of the finance has no recourse whatsoever to the other assets of the Group. The transactions are recorded gross of third-party financing.

Securitisation continued

The roles played by the Group in the securitisation process are:

- **originator:** for own assets securitised whereby the Group originates directly or indirectly the exposures included in the securitisation;
- **arranger:** deal structuring, legal framework, marketing, and distribution to the market;
- **sponsor:** establishes and manages an asset backed commercial paper programme or other scheme that purchases exposures from third parties i.e. acting as conduit; and
- **contractual party:** deposit account holder, manager of the securitisation (including monitoring of the underlying assets on behalf of investors), investor reporting.

The Group may also act as investor wherein it holds a position in a securitisation transaction for which it is neither originator nor sponsor. This includes providing swaps and liquidity facilities to securitisation transactions.

The extent of the Group's involvement in transactions is:

- **pre-close:** to follow established business processes to enable the bank to meet its obligations; and
- **post-close:** to perform contractual roles as appropriate.

Calculation of risk-weighted exposure amounts

When calculating RWAs for securitisation transactions the significant risk transfer (SRT) test is applied. SRT tests are conducted regularly in order that the risk associated with the original securitised assets can be derecognised and accordingly the exposures are recognised. If SRT is not achieved, the risks associated with the original assets are retained and the exposure to the securitisation is ignored.

The Group uses either the IRB approach or the standardised approach for calculating capital requirements on securitisation positions. Within the IRB approach the Group applies the ratings based approach to rated positions and the internal assessment approach to unrated asset backed commercial paper programme positions where the Group is the sponsor.

Summary of accounting policies

Treatment of transactions as sales or financings and the recognition of gains on sales

A securitisation transaction is first assessed for any potential requirement to consolidate any of the various vehicles used. The assessment is made considering the requirements of International Accounting Standard (IAS) 27 'Consolidated and Separate Financial Statements' Standing Interpretations Committee (SIC) 12 'Consolidation

– Special Purpose Entities'. Both IAS 27 and SIC 12 require consolidation of entities that are controlled by the Group.

Whether a securitisation transaction is treated as a sale or financing depends on whether the derecognition tests of IAS 39 'Financial Instruments: Recognition and Measurement', are met.

The Group's accounting policy on de-recognition is as follows:

- A financial asset is derecognised when it has been transferred and the transfer qualifies for derecognition. A qualifying transfer requires that the Group either transfers the contractual rights to receive the asset's cash flows or retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. Where substantially all the risks and rewards have been retained, the asset remains on the balance sheet, however where they have been transferred, the asset is derecognised. If substantially all the risks and rewards have not been retained or transferred, the Group assesses whether it has retained control of the asset. If it has not retained control, the asset is derecognised, if it has, it continues to recognise the asset to the extent of its continuing involvement;
- A financial liability is removed from the balance sheet when the obligation is discharged, cancelled, or expires; and
- Sales and gains on sales are recognised only to the extent that de-recognition is achieved. In a traditional securitisation, assets are sold to a special purpose entity at book value and no gain or loss on sale is recognised at inception.

Key assumptions for valuing retained interests

Retained interests are valued with reference to similar portfolios in the market.

Treatment of synthetic securitisations

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

External credit assessment institutions

The Group uses Moody's, Standard & Poor's or Fitch to rate deal structures in their entirety. Usually the services of two or more agencies are used in a transaction.

Additional information is contained in the Group's 2010 Annual Report and Accounts, pages 217 to 220.

Securitisation continued

Table 38: Exposures securitised, by transaction and exposure type

Underlying portfolio	Outstanding amounts of exposures securitised (1)			
	Traditional		Synthetic	
	Originator £m	Sponsor £m	Originator £m	Sponsor £m
2010				
Residential mortgages	1,231	3,798	-	-
Commercial mortgages	456	660	2,255	-
Credit card receivables	29	2,087	-	-
Loans to corporates or SMEs	3,148	205	1,782	-
Consumer loans	-	2,644	-	-
Trade receivables	-	763	-	-
Auto receivables	-	5,291	-	-
Other assets	-	2,069	-	-
	4,864	17,517	4,037	-
2009				
Residential mortgages	1,285	4,217	-	-
Commercial mortgages	5,214	1,056	2,314	-
Credit card receivables	1,475	4,081	-	-
Leasing	-	781	-	-
Loans to corporates or SMEs	4,152	289	-	-
Consumer loans	-	2,209	-	-
Trade receivables	-	1,199	-	-
Auto receivables	-	4,645	-	-
Other assets	-	1,301	-	-
	12,126	19,778	2,314	-

Note:

(1) Exposure values are on the basis of financial statement values as of the date of disclosure. Where this is not available, the current amount of outstanding notes has been used.

Table 39: Impaired and past due exposures securitised, by exposure type and losses

	Outstanding amounts of exposures securitised (1)	
	Impaired/past due	Losses
	Originator £m	Originator £m
2010		
Residential mortgages	133	24
Loans to corporates or SMEs	28	-
	161	24
2009		
Residential mortgages	68	7
Commercial mortgages	53	-
Credit card receivables	143	121
Loans to corporates or SMEs	121	-
	385	128

Notes:

- (1) Exposure values are on the basis of financial statement values as of the date of disclosure. Where this is not available, current amount of outstanding notes has been used.
- (2) There were no outstanding amounts of exposures securitised where the Group was a sponsor.

Securitisation continued

Table 40: Securitisation positions, retained or purchased, by exposure type

Underlying portfolio	Aggregate amount of securitisation positions retained or purchased	
	2010 £m	2009 £m
Residential mortgages	20,937	14,461
Commercial mortgages	5,355	7,618
Credit card receivables	4,094	5,808
Leasing	1,566	2,194
Loans to corporates or SMEs	5,441	7,286
Consumer loans	3,757	3,227
Trade receivables	7,749	8,277
Securitisations/re-securitisations	758	879
Auto receivables	8,593	8,068
Other assets	4,221	3,279
	62,471	61,097

Key point

- The increase in residential mortgages was attributable to RBS N.V transitioning to Basel II during 2010.

Geographic breakdowns for banking book securitisation positions (excluding deductions and counterparty credit risk) have been provided in the credit risk analysis section of this document.

Table 41: Securitisation positions, retained or purchased, by risk weightings

Risk-weight bands	2010			2009		
	Aggregate amount of securitisation positions retained or purchased			Aggregate amount of securitisation positions retained or purchased		
	Exposure amount £m	Capital charges, standardised approach £m	Capital charges IRB approach £m	Exposure amount £m	Capital charges, standardised approach £m	Capital charges IRB approach £m
≤ 10%	33,343	-	209	37,882	-	239
> 10% ≤ 20%	15,763	13	184	8,310	16	97
> 20% ≤ 50%	5,616	1	182	5,995	4	152
> 50% ≤ 100%	3,092	1	228	5,144	34	314
> 100% ≤ 650%	679	24	112	1,343	54	333
1250%/Deduction (1)	3,978	970	3,008	2,423	676	1,747
	62,471	1,009	3,923	61,097	784	2,882

Note:

- (1) The securitisation positions deduction in the regulatory capital table on page 13 includes trading book assets, while the table above is limited to banking book assets only.

Key point

- The increase in the higher risk weightings is due to credit rating downgrades on positions.

Table 42: Exposures to securitisations of revolving assets

	2010 (1,2)		2009 (1,2)	
	Aggregate outstanding amounts		Aggregate outstanding amounts	
	Originators' interest £m	Investors' interest £m	Originators' interest £m	Investors' interest £m
Retail committed	3,917	29	2,631	1,475

Notes:

- (1) Exposure values are on the basis of financial statement values as of the date of disclosure.
 (2) Retail committed balances include drawn credit card receivable balances relating to the transaction.

Securitisation continued

Securitisation activity during the year

During 2010, the Group participated as a sponsor in traditional securitisations as detailed in the following table. During 2009 the Group did not participate in any new securitisation activity. There were no realised gains or losses during 2009.

Table 43: New securitisation activity during the year

Underlying portfolio	Securitisation in 2010 (exposures securitised) (1)
	traditional sponsor £m
Residential mortgages	391
Credit card receivables	920
Consumer loans	657
Trade receivables	49
Auto receivables	1,972
	<u>3,989</u>

Notes:

- (1) Exposure values are as of the date of inception, where this is not available, current amount of outstanding notes has been used.
- (2) RBS N.V. asset migration to the Group is not included.

Market risk

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities.

Structure and organisation

The Group manages market risk centrally within its trading and non-trading portfolios through a comprehensive market risk management framework. This framework includes limits based on, but not limited to VaR, scenario analysis, position and sensitivity analyses. The Group's market risk appetite is defined within this limit framework which is cascaded down through legal entity, division, business and ultimately trader level market risk limits.

The market risk function is independent of the Group's trading businesses and is responsible for:

- effective application and compliance with the Group's market risk policy statement, constraining and aligning the market risk taken by the Group within the risk limits set by the Executive Risk Forum;
- identification, measurement, monitoring, analysis and reporting of the market risk generated by the various businesses; and
- determination of appropriate policies and methodologies to measure and control market risk.

Upon notification of a limit breach, the appropriate body must take one of the following actions:

- instructions can be given to reduce positions to bring the Group within the agreed limits;
- a temporary increase in the limit (for instance, in order to allow orderly unwinding of positions) can be granted;
- to pursue an agreed short-term strategy; and
- a permanent increase in the limit can be granted if consistent with the strategy and supported by the business and Risk Management.

Risk measurement and control

The Group calculates VaR using historical simulation models but does not make any assumption about the nature or type of underlying loss distribution other than implied by history. The methodology uses the previous 500 trading days of market data and calculates both general market risk (the risk due to movement in general market benchmarks) and idiosyncratic market risk (the risk due to movements in the value of securities by reference to specific issuers). Group 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;
- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile;
- VaR that uses 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; and
- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intra-day profit and losses will be incurred.

A 'Risks 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 VaR model alternative controls are in place (for example, position monitoring, sensitivity limits, triggers or stress limits).

The Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of the Group's trading portfolios. The Group calculates historical stress tests and hypothetical stress tests.

Historical stress tests calculate the loss that would be generated if the market movements that occurred during historical market events were repeated. Hypothetical stress tests calculate the loss that would be generated if a specific set of adverse market movements were to occur.

The Global Market Risk Stress Testing Committee reviews and discusses all matters relating to Market Risk Stress Testing. Stress test exposures are discussed with senior management and relevant information is reported to the Group Risk Committee, Executive Risk Forum and the Group Board. Breaches in the Group's market risk stress testing limits are monitored and reported to the Group Board.

In addition to the VaR and stress testing measures discussed above, the Group calculates a wide range of sensitivity and position risk measures, for example interest rate ladders or option revaluation matrices. These measures provide valuable additional controls, often at individual desk or strategy level.

Market risk continued

Model validation governance

Group Risk Analytics provides an independent evaluation of the model for transactions deemed by the Group Model Product Review Committee (GMPRC) to be large, complex and/or innovative. When marking to market using a model, the valuation methodologies are reviewed and approved by the market risk function. Any profits or losses on the revaluation of positions are recognised in the daily profit and loss.

Application of the VaR model

The VaR model has been approved by the FSA to calculate regulatory capital for the trading book, for those legal entities under their regulatory jurisdiction. These legal entities are currently The Royal Bank of Scotland plc; National Westminster Bank plc; and RBS Financial Products Inc. The Regulatory VaR differs from the internal VaR as it is based on a 10 day holding period. The approval covers general market risk in interest rate, foreign exchange, equity and limited commodity products and specific risk in interest rate and equity products.

As the VaR model is an important market risk measurement and control tool and is used for determining a significant component of the market risk capital, it is regularly assessed. One of the main approaches employed is the technique known as back-testing which counts the number of days when a loss (as defined by the FSA) exceeds the corresponding daily VaR estimate, measured at a 99% confidence level. The FSA categorises a VaR model as green, amber or red. A green model is consistent with a good working model and is achieved for models that have four or less back-testing exceptions in a 12 month period. For the Group's trading book, a green model status was maintained through 2010.

Traded portfolios

Financial instruments held in the Group's trading portfolios include, but are not limited to: debt securities, loans, deposits, equities, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options).

The Group participates in exchange traded and over-the-counter (OTC) derivative markets. The Group buys and sells financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide daily margins with cash or other security at the exchange, to which the holders look for ultimate settlement.

Financial instruments that are traded OTC, rather than on a recognised exchange, range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to the requirements of the Group's customers. In many cases industry standard documentation is used, most commonly in the form of a master agreement, with individual transaction confirmations.

Marking to market/model/reserving

To ensure that the risks associated with dealing activity are reflected in the financial and management statements, assets and liabilities in the trading book are measured at their fair value. Any profits or losses on the revaluation of positions are recognised in the income statement on a daily basis. Fair value is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair values are determined following IAS 39 guidance which requires banks to use quoted market prices or valuation techniques (models) that make the maximum use of observable inputs. When marking to market using a model, the valuation methodologies are reviewed and approved by the market risk function.

Traders are responsible for marking to market their trading book positions on a daily basis. Traders can either:

- directly mark a position with a price (e.g. spot FX); or
- indirectly mark a position through the marking of inputs of an approved model which will in turn generate a price.

Independent price verification

Independent price verification is a key additional control over front office marking of positions and operates to assist the validation of:

- the balance sheet at key reporting dates; and
- book level daily profit and loss used for management reporting and regulatory back-testing.

All positions held within trading books require independent price verification. Independent price verification for this purpose is the independent review and validation of trader marks and may be achieved by:

- independently testing prices for specific positions; or
- independently testing all variable model inputs to the relevant approved valuation model.

The key management factors include:

- *Appropriate financial controls:* financial controllers are responsible for ensuring that independent price verification processes are in place covering all trading book positions held by their business. Daily independent price verification is performed for positions where prices/model inputs are readily available on a daily basis. For positions where prices/model inputs are available on a less regular basis, verification may occur on a frequency that is less than daily. Where practical, verification is performed to a frequency that matches the availability of this independent price information.

Market risk continued

- **Compliance statements:** financial control is required to prepare and maintain compliance statements that benchmark price verification procedures against the independent pricing policy. Each compliance statement requires review and sign off from market risk, front office management and the relevant financial controller on a minimum six monthly basis.

- **Independent validation:** there is a minimum requirement that independent price verification is carried out monthly. It is a regulatory requirement that all trading book positions are marked to market on a daily basis. If the use of finance's independent valuations would lead to a markdown in excess of the profit and loss adjustment trigger for an individual desk, then the books are re-marked to independent prices. Individual desks and the trigger over which escalation will occur are defined within the compliance statement for that business area.

Table 44: Market risk minimum capital requirement

	2010 £m	2009 £m
Trading book business – interest rate position risk requirement	405	279
Other – position risk requirement (1)	955	973
Business activities – commodity position risk requirement	-	5
Total (standard method)	1,360	1,257
Capital requirement for aggregation entities	873	908
VaR model based position risk requirement	4,175	3,059
Total position risk requirement	6,408	5,224

Note:

- (1) Other position risk requirement for 2010 is due to intermediation trades not approved for inclusion in the VaR model based capital approach. The capital charge for these trades is calculated as 100% of the current value of the position. In 2009, the charge was due to the transfer of trades from ABN to RBS where the underlying risk was unchanged but the trades were subject to different capital treatments changing from a VaR model based approach in ABN to standardised rules in RBS

Key points

- Interest rate position risk requirement increased significantly in 2010 compared to 2009 due to the inclusion of new products transferred from RBS N.V. to RBS plc.
- Commodity position risk requirement reduced to nil as the Group's interest in RBS Sempra Commodities JV was sold.
- VaR model based position risk requirement increased in 2010 compared to 2009 due to the introduction of an event risk charge.

The table below analyses the VaR for the Group's trading portfolio's segregated by type of market risk exposure.

Table 45: Market risk traded VaR

	2010				2009			
	Average £m	Period end £m	Maximum £m	Minimum £m	Average £m	Period end £m	Maximum £m	Minimum £m
Trading VaR								
Interest rate	51.6	57.0	83.0	32.5	57.0	50.5	112.8	28.1
Credit spread	166.3	133.4	243.2	110.2	148.3	174.8	231.2	66.9
Currency	17.9	14.8	28.0	8.4	17.9	20.7	35.8	9.2
Equity	9.5	10.9	17.9	2.7	13.0	13.1	23.2	2.7
Commodity	9.5	0.5	18.1	0.5	14.3	8.9	32.1	6.5
Diversification		(75.6)				(86.1)		
	168.5	141.0	252.1	103.0	155.2	181.9	229.0	76.8

Key points

- The Group's period end VaR reduced as the exceptional volatility of the market data from the period of the financial crisis dropped out of the 500 days of time series data used in the VaR calculation. The credit spread VaR was particularly impacted as a result of this effect.
- The Group's maximum and average credit and Non-Core VaR were higher in 2010, than in 2009 due to Non-Core exiting several highly structured positions which due to their complexity and layering, required unwinding with different counterparties over different periods. The timing of the unwind temporarily led to an increased VaR, until the exit was completed in October and the VaR then reduced back to the levels held earlier in the year.
- Commodity VaR decreased during the year since a significant part of the Group's interest in Sempra JV was sold during the year.

Operational risk

Strategy and process

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

The Group is committed to maintaining high standards of operational risk management. Operational risks are inherent in the Group's business and although the Group has implemented risk controls and loss mitigation actions, it is only possible to be reasonably, but not absolutely certain, that such procedures will be effective in controlling each of the operational risks faced by the Group.

Structure and organisation

Ultimate accountability for setting the operational risk strategy and appetite rests with the Group Board which has delegated authority to key Group-level committees. The committees that support the Group Board in the effective management of operational risk include:

- Group Audit Committee;
- Executive Committee;
- Board Risk Committee;
- Executive Risk Forum;
- Group Risk Committee; and
- Divisional Risk and Audit Committee or equivalent.

The Group Operational Risk (GOR) department is an independent function reporting to the Deputy Group Chief Risk Officer that is responsible for the design and maintenance of the Operational Risk Policy Standards.

Group Policy Framework (GPF)

The GPF supports a consistent approach as to how the Group does business and helps everyone understand their individual and collective responsibilities. It is a core component of the Group's Risk Appetite Framework; it supports the risk appetite setting process, and also underpins the control environment.

Work to design, implement and embed an enhanced GPF has continued throughout 2010 and will extend into 2011. The Group's plans for ongoing development of GPF will support increased consistency in risk appetite setting across all risk types faced by the Group, including alignment to the Group's strategic business and risk objectives. The Group will use relevant external reference points such as peers and rating agencies to challenge and verify the content of the Policy Standards making up GPF.

Appropriate and effectively implemented Policy Standards are a fundamental component of GPF and support attainment and maintenance of an 'upper quartile' control framework as compared against the Group's relevant peer set.

The GPF requires consideration and agreement through Group governance of the level of risk appetite the Group has and how this is justifiable in the context of its strategic objectives.

There will be ongoing reassessment of risks, risk appetite and controls within the GPF and where appropriate, potential issues will be identified and addressed to ensure the Group moves in line with the Group's objectives and remains constantly aligned with the 'upper quartile' objective and market practice at all times.

Through the three lines of defence model the Group obtains assurance that the standards in the GPF are being adhered to and GPF defines requirements for testing and gathering evidence which demonstrates that each division and function is appropriately controlled.

GPF is owned and managed by the Group's operational risk function and relies upon the operational risk framework for effective implementation and ongoing maintenance.

Three lines of defence model

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational risk, the Group operates three lines of defence model which outlines principles for the roles, responsibilities and accountabilities for operational risk management.

1st line of defence – The business

- Accountable for the ownership and day-to-day management and control of operational risk.
- Responsible for implementing processes in compliance with Group policies.
- Responsible for testing key controls and monitoring compliance with Group policies.

2nd line of defence – Operational risk

- Responsible for the implementation and maintenance of the operational risk framework, tools and methodologies.
- Responsible for oversight and challenge on the adequacy of the risk and control processes operating in the business.

3rd Line of defence – Group Internal Audit

- Responsible for providing independent assurance on the design, adequacy and effectiveness of the Group's system of internal controls.

Operational risk continued

Operational Risk Policy Standards

The Group's Operational Risk Policy Standards (ORPS) are incorporated in the Group Policy Framework. They provide the direction for delivering effective operational risk management and are designed to enable the consistent identification, assessment, management, monitoring and reporting of operational risk across the Group. The objectives of the ORPS are to protect the Group from financial loss or damage to its reputation, its customers or staff and to ensure that it meets all necessary regulatory and legal requirements.

Key operational risk processes covered by the ORPS are:

- risk and control assessments;
- scenario analysis;
- loss data management;
- new products approval process; and
- self certification process.

These Group-wide operational risk processes ensure that the adequacy and effectiveness of internal controls for managing risks inherent in the business processes, are regularly monitored and shortcomings are addressed on a timely basis.

Measurement systems

Key elements used for the measurement of operational risk include:

- *Risk and control assessments*: business units identify and assess operational risks to ensure that they are effectively managed, prioritised, documented and aligned to risk appetite.
- *Scenario analysis*: scenarios for operational risk are used to assess the possible impact and likelihood of extreme but plausible operational risk loss events. Scenario assessments provide a forward-looking basis for managing exposures that are beyond the Group's risk appetite.
- *Loss data management*: each business unit's internal loss data management process captures all operational risk loss events above certain minimum thresholds. The data is used to enhance the adequacy and effectiveness of controls, identify opportunities to prevent or reduce the impact of recurrence, identify emerging themes, enable formal loss event reporting and inform risk and control assessments and scenario analysis. Escalation of individual events to senior management is determined by the seriousness of the event.
- *New product approval process*: this process ensures that all new products or significant variations to existing products are subject to a comprehensive risk assessment. Products are evaluated and approved by specialist areas and are subject to executive approval prior to launch.

- *Self certification process*: this requires management to monitor and report regularly on the internal control framework for which they are responsible, confirming its adequacy and effectiveness. This includes certifying compliance with the requirements of Group policies.

Scope and nature of reporting and measurement systems

Reporting forms an integral part of operational risk management. The Group's risk management processes are designed to ensure that operational risk issues are identified quickly, escalated and managed on a timely basis.

Exposures for each division are reported through monthly risk and control reports, which provide detail on the risk exposures and action plans. Events that have a material, actual or potential impact on the Group's finances, reputation or customers, are escalated and reported to divisional and Group executive.

Policies for hedging and mitigating

Operational risk is an integral and unavoidable part of the Group's business as it is inherent in the processes it operates to provide services to the customers and generate profit for shareholders.

An objective of operational risk management is not to remove operational risk altogether, but to manage the risk to an acceptable level, taking into account the cost of minimising the risk as against the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

The ORPS require each business unit to determine appropriate mitigation techniques to reduce its risk exposure to an acceptable level, and confirm that the adequacy and effectiveness of controls and other risk mitigants (e.g. insurance) are tested regularly and the results documented. Where unacceptable control weaknesses are identified, action plans must be produced and tracked to completion.

The Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements. Insurance is primarily used as an additional risk mitigation tool in controlling the Group's exposures. However, insurance only provides protection against financial loss once a risk has occurred.

The Group calculates the capital requirement for operational risk using the Standardised Approach (TSA). The capital requirements are as follows:

Table 46: Operational risk minimum capital requirement

	2010 £m	2009 £m
Operational risk capital requirement (TSA)	2,968	2,712

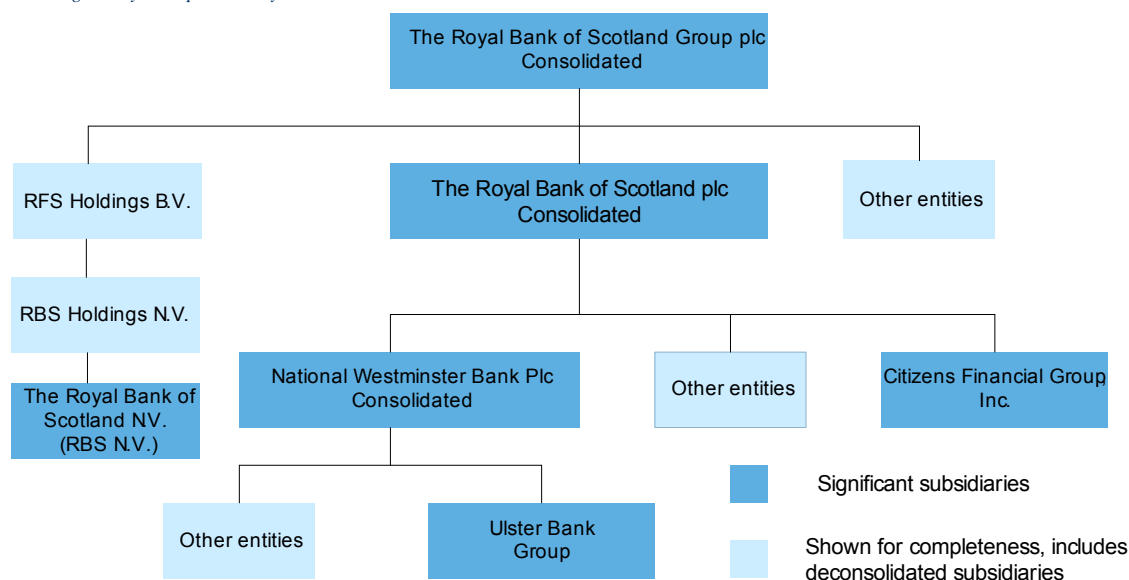
Further information on the Group's operational risk framework can be found in the Group's 2010 Annual Report and Accounts on pages 199 to 202.

Additional disclosures

Significant subsidiaries

Chart 5 represents a simplified regulatory hierarchy of the Group, specifically highlighting those subsidiaries and regions which are of significance. The Group has considered the requirements of the significant subsidiary disclosures and concluded that the following entities are within scope; The Royal Bank of Scotland plc Consolidated, National Westminster Bank Plc Consolidated, Ulster Bank Group, RBS N.V. and Citizens Financial Group, Inc.

Chart 5: Regulatory Group hierarchy



As highlighted by the diagram, data for these five significant subsidiaries does not aggregate to the overall Group position.

Table 47: Significant subsidiaries minimum capital requirements

Risk type	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	Citizens Financial Group £m
2010					
Credit risk	30,628	8,671	3,065	6,047	4,802
Market risk	6,314	676	11	90	-
Operational risk	2,871	1,156	186	85	432
Concentration risk (1)	147	-	-	-	-
	39,960	10,503	3,262	6,222	5,234
2009					
Credit risk	32,815	8,875	2,762	13,059	5,272
Market risk	5,056	243	7	169	-
Operational risk	2,700	1,137	156	-	420
	40,571	10,255	2,925	13,228	5,692

Note:

(1) The concentration risk charge is calculated on intra group large exposure balances and arose mainly due to increased trading book derivative exposures with RBS N.V.

Additional disclosures continued

Significant subsidiaries (continued)

Table 48: Significant subsidiaries RWAs

Risk type	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	Citizens Financial Group £m
2010					
Credit risk	382,855	108,396	38,312	75,586	60,025
Market risk	78,928	8,447	135	1,127	-
Operational risk	35,888	14,454	2,325	1,057	5,404
Concentration risk	1,838	-	-	-	-
	499,509	131,297	40,772	77,770	65,429
2009					
Credit risk	410,191	110,934	34,525	163,234	65,899
Market risk	63,198	3,047	91	2,108	-
Operational risk	33,748	14,214	1,944	-	5,249
	507,137	128,195	36,560	165,342	71,148

Table 49: Significant subsidiaries credit risk minimum capital requirements summary

Credit risk approach	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m	Citizens Financial Group £m
2010					
Advanced IRB	18,503	7,263	2,951	3,106	-
Standardised	8,034	1,163	28	1,317	4,730
Counterparty credit risk	4,091	245	86	1,624	72
	30,628	8,671	3,065	6,047	4,802
2009					
Advanced IRB	19,914	7,745	2,686	-	-
Standardised	8,152	922	14	-	5,217
Counterparty credit risk	4,749	208	62	-	55
Standardised in transition	-	-	-	13,059	-
	32,815	8,875	2,762	13,059	5,272

Note:

(1) Credit risk capital requirements include both intra-group and non-customer assets.

Additional disclosures continued

Significant subsidiaries (continued)

Table 50: Significant subsidiaries credit risk advanced IRB minimum capital requirement

Advanced IRB exposure class and sub-class	2010			
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m
Central governments and central banks	102	9	4	173
Institutions	179	52	4	521
Corporates	11,405	3,904	1,664	2,133
Retail	5,238	2,969	1,197	-
retail SME	1,023	827	180	-
retail secured by real estate collateral	2,449	910	910	-
qualifying revolving retail exposures	1,074	727	68	-
other retail exposures	692	505	39	-
Equities	200	25	1	194
exchange traded exposures	59	-	-	24
private equity exposures	17	10	1	118
other exposures	124	15	-	52
Securitisation positions	699	-	1	91
Non-credit obligation assets	680	304	80	(6)
	18,503	7,263	2,951	3,106

Advanced IRB exposure class and sub-class	2009		
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m
Central governments and central banks	42	11	3
Institutions	195	52	4
Corporates	12,368	4,384	1,684
Retail	5,258	2,942	914
retail SME	1,208	968	208
retail secured by real estate collateral	2,065	574	574
qualifying revolving retail exposures	1,072	745	78
other retail exposures	913	655	54
Equities	282	34	1
exchange traded exposures	55	-	-
private equity exposures	126	20	1
other exposures	101	14	-
Securitisation positions	1,017	4	-
Non-credit obligation assets	752	318	80
	19,914	7,745	2,686

Notes:

- (1) Excludes counterparty credit risk assets.
- (2) RBS N.V. is included in the table above for 2010 and excluded for 2009 when it was Basel I in transition.
- (3) Citizens is not included in the table above as it is wholly on the Basel II standardised approach.

Additional disclosures continued

Significant subsidiaries (continued)

Table 51: Significant subsidiaries credit risk standardised minimum capital requirement

Standardised exposure class	2010				
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. Financial Group £m	Citizens £m
Central governments and central banks	11	10	-	16	-
Regional governments and local authorities	2	-	-	15	1
Administrative bodies and non-commercial undertakings	4	-	-	-	4
Institutions	225	42	-	8	9
Corporates	4,149	539	3	478	2,431
Retail	1,923	197	2	60	1,464
Secured by real estate property	388	131	-	18	158
Past due items	180	36	22	16	64
Securitised positions	425	-	-	-	425
Other items	727	208	1	706	174
	8,034	1,163	28	1,317	4,730

Standardised exposure class	2009			
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	Citizens Financial Group £m
Central governments and central banks	1	-	-	-
Regional governments and local authorities	2	-	-	2
Administrative bodies and non-commercial undertakings	6	-	-	6
Institutions	216	41	-	8
Corporates	3,692	373	2	2,356
Retail	2,042	185	3	1,556
Secured by real estate property	372	90	-	187
Past due items	166	19	-	104
Securitised positions	784	-	-	784
Collective investment undertakings	1	1	-	-
Other items	870	213	9	214
	8,152	922	14	5,217

Table 52: Significant subsidiaries counterparty credit risk and concentration requirement

	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. Financial Group £m	Citizens £m
2010					
Counterparty credit risk	4,091	245	86	1,624	72
Concentration risk capital component	147	-	-	-	-
2009					
Counterparty credit risk	4,749	208	62	-	55

Additional disclosures continued

Significant subsidiaries (continued)

Table 53: Significant subsidiaries market risk trading book and other business

	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. £m
2010				
Trading book business				
Interest rate position risk requirement	403	21	-	1
Any other position risk requirement	955	-	-	-
Business activities	-	-	-	-
Foreign exchange position risk requirement	-	-	1	1
Total (standard method)	1,358	21	1	2
Capital requirement for aggregation entities	781	643	10	88
VaR model based position risk requirement	4,175	12	-	-
Grand total position risk requirement	6,314	676	11	90
2009				
Trading book business				
Interest rate position risk requirement	279	8	-	-
Business activities	973	-	-	-
Commodity position risk requirement	-	-	-	-
Foreign exchange position risk requirement	6	-	-	-
Total (standard method)	1,258	8	-	-
Capital requirement for aggregation entities	739	214	7	169
VaR model based position risk requirement	3,059	21	-	-
Grand total position risk requirement	5,056	243	7	169

Additional disclosures continued

Significant subsidiaries (continued)

Table 54: Significant subsidiaries capital resources

	2010				
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V.(1) £m	Citizens Financial Group (2) £m
Tier 1					
Ordinary and B shareholders' equity	55,589	15,054	3,738	4,052	14,619
Non-controlling interests	597	1,315	558	21	-
Adjustments for:					
Goodwill and other intangible assets – continuing	(11,832)	(683)	-	(22)	(7,310)
Goodwill and other intangible assets – discontinued	-	-	-	-	-
Unrealised losses on available-for-sale debt securities	(843)	(9)	1	2,181	(105)
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	(74)	-	-	(97)	-
Reallocation of preference shares and innovative securities	-	(1,192)	-	-	-
Other regulatory adjustments	(818)	13	(573)	(835)	538
Less: expected losses over provisions net of tax	(1,998)	(1,254)	(781)	(338)	-
Less securitisation positions	(1,916)	(829)	(12)	(103)	-
Less APS first loss	(4,225)	-	-	-	-
Core Tier 1 capital	34,480	12,415	2,931	4,859	7,742
Preference shares	2,890	1,489	1,463	2,087	326
Innovative Tier 1 securities	3,638	-	-	-	-
Tax on excess of expected losses over provisions	797	500	312	-	-
Less deductions from Tier 1 capital	(242)	(333)	-	(215)	-
Total Tier 1 capital	41,563	14,071	4,706	6,731	8,068
Tier 2					
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	74	-	-	97	-
Collective impairment allowances	672	4	4	-	780
Perpetual subordinated debt	4,925	1,597	103	3,539	-
Term subordinated debt	18,067	4,931	1,097	-	52
Non-controlling and other interests in Tier 2 capital	11	-	-	-	-
Less excess of expected losses over provisions	(2,795)	(1,754)	(1,093)	(338)	-
Less securitisation positions	(1,916)	(829)	(12)	(103)	-
Less material holdings	(242)	(333)	-	(215)	-
Less APS first loss	(4,225)	-	-	-	-
Total Tier 2 capital	14,571	3,616	99	2,980	832
Supervisory deductions					
Unconsolidated investments - RBS Insurance	(116)	(116)	-	-	-
Other deductions	(267)	(177)	-	(133)	-
Deductions from total capital	(383)	(293)	-	(133)	-
Total regulatory capital	55,751	17,394	4,805	9,578	8,900

Notes:

- (1) RBS N.V. disclosure is driven off the DNB disclosure; with specific national discretions applied by DNB.
- (2) Citizens disclosure is driven by FED Band 1 which does not incorporate a Core Tier 1 definition. The above amount shows value for Core Tier 1.

Additional disclosures continued

Significant subsidiaries (continued)

Table 54: Significant subsidiaries capital resources (continued)

	2009				
	RBS Consolidated £m	NatWest Consolidated £m	Ulster Bank Group £m	RBS N.V. Financial Group £m	Citizens Financial Group £m
Tier 1					
Ordinary and B shareholders' equity	53,630	14,199	3,235	17,029	13,732
Non-controlling interests	1,146	1,282	522	33	-
Adjustments for:					
Goodwill and other intangible assets - continuing	(11,814)	(748)	-	(91)	(7,271)
Goodwill and other intangible assets - discontinued	(238)	-	-	-	-
Unrealised losses on available-for-sale debt securities	279	(12)	(1)	940	(78)
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	(184)	(109)	-	(194)	-
Reallocation of preference shares and innovative securities	-	(1,207)	(519)	-	-
Other regulatory adjustments	(796)	(492)	15	(95)	755
Less: expected losses over provisions net of tax	(2,560)	(1,351)	(806)	-	-
Less securitisation positions	(1,270)	(380)	(9)	-	-
Less APS first loss	(4,654)	-	-	-	-
Core Tier 1 capital	33,539	11,182	2,437	17,622	7,138
Preference shares	2,883	1,532	1,478	2,011	312
Innovative Tier 1 securities	3,542	-	-	2,441	-
Tax on excess of expected losses over provisions	1,020	539	322	-	-
Less deductions from Tier 1 capital	(132)	(327)	-	(1,319)	(1)
Total Tier 1 capital	40,852	12,926	4,237	20,755	7,449
Tier 2					
Reserves arising on revaluation of property and unrealised gains on available-for-sale equities	184	109	-	194	-
Collective impairment allowances	796	3	3	-	809
Perpetual subordinated debt	7,170	2,170	107	750	-
Term subordinated debt	18,860	4,830	1,091	6,212	99
Non-controlling and other interests in Tier 2 capital	11	-	-	-	-
Less deductions from Tier 2 capital	(4,982)	(2,598)	(1,137)	(1,319)	-
Less APS first loss	(4,654)	-	-	-	-
Total Tier 2 capital	17,385	4,514	64	5,837	908
Supervisory deductions					
Unconsolidated investments	(121)	(121)	-	-	-
Other	(93)	(170)	-	-	-
Deductions from total capital	(214)	(291)	-	-	-
Total regulatory capital	58,023	17,149	4,301	26,592	8,357

Note:

- (1) RBS consolidated had additional capital requirements under the Basel I transitional floor rules of £3.3 billion. RBS consolidated had capital resources which exceeded this floor of £26.6 billion.

Additional disclosures continued

Past due and impaired assets

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

A loan is impaired when 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.

Impairment loss provision methodology

Provisions for impairment losses are assessed under three categories:

- **Individually assessed provisions:** provisions required for individually significant impaired assets which are assessed on a case by case basis, taking into account the financial condition of the counterparty and any guarantor and collateral held after being stressed for downside risk. This incorporates an estimate of the discounted value of any recoveries and realisation of security or collateral. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.
- **Collectively assessed provisions:** provisions on impaired credits below an agreed threshold which are assessed on a portfolio basis, to reflect the homogeneous nature of the assets, such as credit cards or personal loans. The provision is determined from a quantitative review of the relevant portfolio, taking account of the level of arrears, security and average loss experience over the recovery period.

- **Latent loss provisions:** provisions held against the impairments in the performing portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date. The Group has developed methodologies to estimate latent loss provisions that reflect:

- historical loss experience adjusted where appropriate, in the light of current economic and credit conditions; and
- the period ('emergence period') between an impairment event occurring and a loan being identified and reported as impaired.

Provision analysis

The Group's consumer portfolios, which consist of high volume, small value credits, have highly efficient largely automated processes for identifying problem credits in short timescales, typically three months, before resolution or adoption of various recovery methods. Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements. Provisions are assessed on a case-by-case basis by experienced specialists with input from professional valuers and accountants. The Group operates a clear provisions governance framework which sets thresholds whereby suitable oversight and challenge is undertaken and significant cases will be presented to a committee chaired by the Group Chief Executive or the Group Finance Director.

Additional disclosures continued

Past due and impaired assets (continued)

Disclosure basis

The following tables detailing past due and impaired assets and provisions are presented on an IFRS basis rather than on a regulatory basis. These tables include RBS N.V. on the same basis as the 2010 Annual Report and Accounts

Table 55: Past due exposures, impaired exposures and provisions by industry sector

Industry sector	Impaired assets (1) £m	Past due assets £m	Individually and collectively assessed provisions £m	Latent provisions £m	Charge to income statement (2) £m
2010					
Agriculture and fisheries	136	16	86		31
Building and construction	2,114	350	875		530
Business services	763	145	447		334
Financial services	1,963	157	1,276		438
Manufacturing	1,272	66	552		(190)
Individuals	7,409	412	3,769		2,384
Power and water	90	2	23		14
Property	18,284	1,300	6,736		4,682
Public sector and quasi government	786	269	321		159
Technology, media and telecommunication	392	-	253		142
Tourism and leisure	1,187	84	502		320
Transport and storage	240	7	119		87
Wholesale and retail trade	1,065	89	573		334
Latent				2,650	(121)
	35,701	2,897	15,532	2,650	9,144
2009					
Agriculture and fisheries	352	25	193		95
Building and construction	1,901	352	533		487
Business services	1,315	73	728		573
Financial services	2,642	351	1,180		1,287
Manufacturing	3,829	158	2,592		1,766
Individuals	7,593	452	3,798		3,561
Power and water	27	1	17		16
Property	12,918	1,499	3,475		3,322
Public sector and quasi government	1,478	154	407		223
Technology, media and telecommunications	239	-	134		419
Tourism and leisure	910	111	315		318
Transport and storage	262	6	118		144
Wholesale and retail trade	1,559	42	717		611
Latent				3,076	1,312
	35,025	3,224	14,207	3,076	14,134

Notes:

- (1) Impaired assets exclude debt securities and equity shares totalling £1,915 million (2009 - £2,415 million).
- (2) The charge to the income statement for impairment losses on debt securities and equity shares totalling £112 million (2009 - £816 million) is excluded from the above.

Additional disclosures continued

Past due and impaired assets (continued)

Table 56: Past due exposures, impaired exposures and provisions by geographic area

Geographic area (1)	Impaired assets (2) £m	Past due assets £m	Individually and collectively assessed provisions £m	Latent provisions £m	Charge to income statement (3) £m
2010					
UK	15,738	2,373	7,389		3,949
Europe	16,080	356	6,643		3,747
North America	2,243	87	785		1,190
Rest of World	1,640	81	715		379
Latent				2,650	(121)
	35,701	2,897	15,532	2,650	9,144
2009					
UK	13,781	2,235	5,812		4,702
Europe	15,922	673	6,507		3,999
North America	3,870	289	1,071		3,209
Rest of World	1,452	27	817		912
Latent				3,076	1,312
	35,025	3,224	14,207	3,076	14,134

Notes:

- (1) The analysis by geographic area is based on the location of the lender. This analysis is used for financial reporting and differs from the disclosure in the credit risk section of this document which is based on the country of incorporation of the counterparty.
- (2) Impaired assets exclude debt securities and equity shares totalling £1,915 million (2009 - £2,415 million).
- (3) The charge to the income statement for impairment losses on debt securities and equity shares totalling £112 million (2009 - £816 million) is excluded from the above.

Table 57: Provisions movement

	Individually assessed provisions £m	Collectively assessed provisions £m	Latent provisions £m	Total £m
Balance at 1 January 2009	4,970	4,102	1,944	11,016
Currency translation and other adjustments	(330)	(78)	(122)	(530)
Disposals	(65)	-	-	(65)
Transfer to disposal groups	(155)	(111)	(58)	(324)
Amounts written-off	(3,940)	(2,999)	-	(6,939)
Recovery of amounts previously written-off	94	305	-	399
Charged to the income statement (1)	8,625	4,197	1,312	14,134
Unwind of discount	(246)	(162)	-	(408)
Balance at 31 December 2009	8,953	5,254	3,076	17,283
Currency translation and other adjustments	(15)	27	31	43
Disposals	(1,344)	(526)	(302)	(2,172)
Transfer to disposal groups	(72)	-	-	(72)
Amounts written-off	(3,323)	(2,719)	-	(6,042)
Recovery of amounts previously written off	90	321	-	411
Charged to income statement - continued (2)	6,195	3,070	(121)	9,144
Charged to income statement - discontinued	35	41	(34)	42
Unwind of discount	(283)	(172)	-	(455)
Balance at 31 December 2010	10,236	5,296	2,650	18,182

Notes:

- (1) Impairment losses on debt securities and equity shares totalling £112 million (2009 - £816 million) are excluded from the above.
- (2) Includes provisions against loans and advances to banks.

Additional disclosures continued

Non-trading book exposures in equities

Non-trading equity risk is defined as the potential variation in the Group's non-trading income and reserves arising from changes in equity prices/income.

Objective

Equity positions in the non-trading book are retained to achieve strategic objectives, support venture capital transactions, or in respect of customer restructuring arrangements.

Risk control framework

The commercial decision to invest in equity holdings, including customer restructurings, is taken by authorised persons with delegated authority under the Group credit approval framework. Investments or disposals of a strategic nature are referred to the Group Acquisitions and Disposal Committee (ADCo), Group Executive Committee (EXCo), and where appropriate the Board for approval; those involving the purchase or sale by the Group of subsidiary companies also require Board approval, after consideration by EXCo and/or ADCo.

The risk arising from these holdings is mitigated by proper controls and identification of risk prior to investing.

Identification

At overall Group level exposures are monitored and reported quarterly by Group Treasury to GALCO.

Equity positions are measured at fair value. Fair value calculations are based on available market prices where possible. In the event that market prices are not available, fair value is based on appropriate valuation techniques or management estimates.

The table below sets out the balance sheet value of the Group's non-traded equity exposures at December 2010, which is the same as fair value.

All quantitative disclosures below exclude the Group's insurance/assurance businesses.

Table 58: Non-traded equity exposures at balance sheet value

Equity exposure type	Balance sheet value 2010 £m	Fair value 2010 £m	Balance sheet value 2009 £m	Fair value 2009 £m
Exchange-traded equity exposures	535	535	401	401
Private equity	953	953	1,309	1,309
Other	1,128	1,128	1,078	1,078
	2,616	2,616	2,788	2,788

Notes:

- (1) Exposure values provided include both the standardised and advanced IRB equities.
- (2) December 2009 numbers have been restated to include RBS N.V., which was out of scope at 31 December 2009

The types, nature and amounts of exchange-traded exposures, private equity exposures, and other exposures vary significantly. Such exposures may take the form of listed and unlisted equity shares, linked equity fund investments, private equity and venture capital investments, preference shares classified as equity and Federal Home Loan Stock. The following table shows the net realised and unrealised gains or losses from equities:

Table 59: Net realised and unrealised gains or losses from equities

	2010 £m	2009 £m
Net realised gains arising from disposals	19	215
Unrealised gains and losses included in Tier 1, 2 or 3 capital	132	491

Notes:

- (1) This includes gains or losses on available-for-sale instruments only.
- (2) December 2009 numbers have been restated to include RBS N.V., which was out of scope at 31 December 2009

Cumulative losses on equity securities designated as at fair value through profit or loss but not held for trading purposes were £216 million at 31 December 2010.

Additional disclosures continued

Interest Rate Risk in the Banking Book (IRRBB)

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

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

Interest rate risk in the banking book (IRRBB) is assessed using a set of standards to define, measure and report the market risk. These standards incorporate, inter alia, the expected divergence between contractual terms and actual behaviour of commercial and personal fixed rate loan portfolios due to refinancing incentives, as well as the risk associated with structural hedges of interest rate insensitive current account portfolios which relates primarily to the stability of the portfolio.

It is the Group's policy to minimise interest rate sensitivity in banking book portfolios and where interest rate risk is retained to ensure that appropriate measures and limits are applied. Key conventions in evaluating IRRBB are subjected to approval of divisional ALCOs and GALCO. Limits on IRRBB are proposed by the Group Treasurer for approval by Executive Risk Forum annually.

IRRBB is measured using a version of the same VaR methodology that is used for the Group's trading portfolios. Net interest income exposures are measured in terms of sensitivity over time to movements in interest rates. Additionally, Citizens measures the sensitivity of the market value of equity to changes in forward interest rates.

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

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

Citizens and Global Banking & Markets manage their own IRRBB exposures within approved limits to satisfy their business objectives.

Residual risk positions are routinely reported to divisional ALCOs and monthly to the Balance Sheet Management Committee, GALCO, the Group Board and Executive Risk Forum.

Table 60: IRRBB VaR for retail and commercial banking activities at a 99% confidence level

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

Table 61: IRRBB VaR by currency

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

Key points

- Interest rate exposure at 31 December 2010 was slightly lower than at the end of 2009. The exposure in 2010 was on average 33% below the average for 2009.
- In general, actions taken throughout 2010 to mitigate earnings sensitivity from interest rate movements were executed in US dollars, hence the year-on-year shift in VaR by currency.

Additional disclosures continued

Sensitivity of net interest income

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

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

Table 62: Sensitivity of net interest income

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

Table 63: Net interest income sensitivity by currency

	GBP £m	USD £m	EUR £m	Other £m	Total £m
Up 100bps	186	11	25	10	232
Down 100bps	(212)	(99)	(33)	(8)	(352)

Key points

- The Group executed transactions in 2010 to reduce the exposure to rising rates related to capital raised in December 2009.
- Actions taken during the year increased the current base level of net interest income, while reducing the Group's overall asset sensitivity.

Appendix 1

Glossary of acronyms

APS	Asset Protection Scheme
AQ	Asset quality
BEEL	Best estimate of expected loss
BIPRU	The Prudential Sourcebook for Banks, Building Societies and Investment Firms
CCF	Credit conversion factor
CCR	Counterparty credit risk
CDS	Credit default swaps
CRD	Capital Requirements Directive
CRM	Credit risk mitigation
CVA	Credit valuation adjustments
EAD	Exposure at default
ECG	Executive Credit Group
ERF	Executive Risk Forum
EU	European Union
EVE	Economic value of equity
ExCo	Executive Committee
FSA	Financial Services Authority
GAC	Group Audit Committee
GALCO	Group Asset and Liability Management Committee
GRC	Group Risk Committee
GRG	Global Restructuring Group
ICAAP	Individual capital adequacy assessment process
IRB	Internal ratings based approach
IRRBB	Interest rate risk in the banking book
LGD	Loss given default
NTER	Non-trading equity risk
ORPP	Operational risk policy and principles
OTC	Over-the-counter
PD	Probability of default
RAR	Risk asset ratio
RemCo	Group Remuneration Committee
RWAs	Risk-weighted assets
SIC	Standard industrial classification
SME	Small and medium sized enterprises
SREP	Supervisory review and evaluation process
the Group	The Royal Bank of Scotland Group plc
TSA	The standardised approach
VaR	Value-at-risk

Appendix 1 continued

Glossary of key terms

Advanced Measurement Approach - in the most advanced approach to operational risk the use of internal models is permitted to calculate the operational risk minimum capital requirement.

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

Basic Indicator Approach (BIA) - the most simplistic of the three approaches to the measurement of operational risk. Under this method a bank calculates its operational risk regulatory capital requirements by taking a single risk-weighted multiple of a three-year average of gross income to produce their regulatory capital requirements.

BIPRU - the Prudential Sourcebook for Banks, Building Societies and Investment Firms.

Collateralised transaction - a transaction for which the borrower provides assets (physical or financial) as security against part, or the whole value, of a loan.

Contingents - a potential obligation that becomes an actual obligation upon a defined event occurring e.g. where conditions set out in a guarantee that require the guarantor to make payment are met.

Counterparty credit risk (CCR) - counterparty credit risk is the risk that a counterparty defaults prior to the maturity of a derivative contract. The risk may result from derivative transactions in either the trading or banking book and is subject to credit limit setting like other credit exposures.

Credit grade - the rating that is linked to the probability of default of a customer. Credit grades represent points of a grading scale.

Credit risk - potential to incur losses from the failure of a customer to meet its obligation to settle outstanding amounts.

Credit risk mitigation (CRM) - a means to reduce the potential loss in the event that a customer fails to settle all or part of its obligations. This includes the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, risk participations, credit insurance, set-off or netting.

Equity risk - risk arising from holding equity positions for investment or strategic purposes.

Expected loss (EL) - the product of PD, LGD and EAD.

Exposure at default (EAD) - an estimate of the credit utilisation, expressed in monetary terms, to a customer in the event of default within the next twelve months. It is calculated as credit utilisation

plus the undrawn portion of the credit limit multiplied by a credit conversion factor. This estimate must not be lower than the current credit utilisation.

E* - the comprehensive (own estimates) approach used to measure adjusted exposure for cases where financial collateral is used for qualifying exposures.

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

Interest rate risk (IRR) - interest rate risk is the exposure of a bank's financial condition to adverse movements in interest rates. Accepting this risk is a normal part of banking and can be an important source of profitability and shareholder value.

Internal Models Method (IMM) - the internal models method for calculating exposure for counterparty credit risk.

Internal Rating Based Approach (IRB) - approach to credit risk under which a bank may use internal estimates to generate risk components for use in their credit risk regulatory capital requirements. There are two approaches: foundation and advanced (including retail).

Latent loss provision - loan impairment provisions held against impairments in the performing loan portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified as impaired at the balance sheet date. The Group has developed methodologies to estimate latent loss provisions that reflect historical loss experience (adjusted for current economic and credit conditions) and the period between an impairment occurring and a loan being identified and reported as impaired.

Leverage - the use of credit facilities, options, futures, margin trading or other financial instruments to increase the potential rate of return from an investment e.g. providing only 10% deposit and using 90% borrowed funds to purchase a property.

Loss given default (LGD) - the economic loss that may occur in the event of default i.e. the actual loss - that part of the exposure that is not expected to be recovered - plus any costs of recovery.

Market risk - the risk of losses to on and off balance sheet positions arising from changes in market price. For instance if any individual buys shares at the current market price, the risk that they may fall in price.

Mark-to-market - the daily adjustment of an account to reflect profits and losses.

Appendix 1 continued

Glossary of key terms (continued)

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

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

Model validation - the process of assessing how well a credit risk model performs using a predefined set of criteria including the discriminatory power of the model, the appropriateness of the inputs and expert opinion.

Netting - the ability of a bank to reduce its credit risk exposures, by offsetting the value of any deposits against loans to the same counterparty.

On balance sheet - items that appear on the bank's balance sheet e.g. loans which have actually been made.

Operational risk - operational risk is the risk of financial loss or reputational impact resulting from fraud, human error, ineffective or inadequately designed processes or systems, improper behaviour, legal events or from external events.

Pillar 1 - minimum capital requirements - the part of the Basel Accord, which sets out the calculations of regulatory capital requirements for credit, market and operational risk.

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

Pillar 3 - market discipline - the part of the Basel Accord, which sets out the disclosure requirements for banks to publish certain details of their risks, capital and risk management, with the aim of strengthening market discipline.

Potential future exposure (PFE) - an add-on to the current mark-to-market replacement cost (if positive) of a given contract to allow for future volatility in interest and/or foreign exchange rates over a specified timeframe, such as the life of the trade, or the close out period if collateralised, to a given confidence level, typically the 95th percentile.

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

Project Finance Supervisory Slotting Approach - project finance (PF) is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure. The FSA has introduced

the supervisory slotting approach to recognise this fact and requires banks to slot these exposures and derive a risk-weight based on the credit characteristics of the contract.

Provision - a liability where the company is uncertain as to the amount or timing of the expected future costs.

Qualifying Revolving Retail Exposure - facilities to retail customers that provide a revolving facility i.e. credit cards.

Repo - repurchase agreements are agreements whereby one party to the transaction agrees to sell securities to the other and at the same time agrees to repurchase the securities at a future date for a specified price. The repurchase price will be fixed at the outset, usually being the original sale price plus an amount representing interest for the period from the sale to the repurchase.

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

Securitisation - is a process by which assets or cash flows are transformed into transferable securities. The underlying assets or cash flows are transferred by the originator or an intermediary, typically an investment bank, to a special purpose entity which issues securities to investors. Asset securitisations involve issuing debt securities (asset-backed securities) that are backed by the cash flows of income-generating assets (ranging from credit card receivables to residential mortgage loans). Liability securitisations typically involve issuing bonds that assume the risk of a potential insurance liability (ranging from a catastrophic natural event to an unexpected claims level on a certain product type).

Share premium account - a balance sheet account represented by the difference between the price received by a company when it sells shares and the par value of those shares.

Special purpose vehicle (SPV) - also known as special purpose entity, a company created for the sole purpose of acquiring certain assets or derivative exposures and issuing liabilities that are thereby linked solely to those assets or exposures. An SPV is designed to be 'bankruptcy remote' – that is, unlikely to be subject to bankruptcy proceedings. SPVs are used to issue all kinds of asset-backed securities, as well as cash collateralised debt obligations and credit linked notes.

Standard industrial classification (SIC) - a classification of businesses by type of economic activity.

Standardised approach - the standard method used to calculate credit risk capital requirements under Pillar 1 of Basel II. In this approach the risk weights used in the capital calculation are determined by regulators.

Stress testing - term describing various techniques used to gauge the potential vulnerability to exceptional but plausible events.

Appendix 1 continued

Glossary of key terms (continued)

The standardised approach (TSA) - the standardised approach to operational risk, calculated using three year historical gross income multiplied by a factor of between 12-18%, depending on the underlying business being considered.

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

Tranched Nth-to-default Basket Swap - is a basket default swap in which the trigger event is the default of some combination of the credits in a specified basket of credits. In the particular case of a first-to-default basket, it is the first credit in a basket of reference credits whose default triggers a payment to the protection buyer. In return for protection against the first-to-default, the protection buyer pays a basket spread to the protection seller as a set of regular accruing cash flows. These payments terminate following the first credit event.

Value-at-risk (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.

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

Wrong way risks (WWR) - this type of risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

Appendix 2 The Asset Protection Scheme

Key aspects of the Scheme

On 22 December 2009, the Group acceded to the Asset Protection Scheme (APS or 'the Scheme') with HM Treasury (HMT) acting on behalf of the UK Government. Under the Scheme, the Group purchased credit protection over a portfolio of specified assets and exposures ("covered assets") from HMT. The portfolio of covered assets had a par value of approximately £282 billion at 31 December 2008 and the protection is subject to a first loss of £60 billion and covers 90% of subsequent losses net of recoveries. Once through the first loss, when a covered asset has experienced a trigger event losses and recoveries in respect of that asset are included in the balance receivable under APS. Receipts from HMT will, over time, amount to 90% of cumulative losses (net of cumulative recoveries) on the portfolio of covered assets less the first loss amount.

The Group has the right to terminate the Scheme at any time provided that the Financial Services Authority has confirmed in writing to HMT that it has no objection. On termination, the Group is liable to pay HMT a termination fee. The termination fee comprises the difference between £2.5 billion (or, if higher, a sum related to the economic benefit of regulatory capital relief obtained from APS) and the aggregate fees paid. In addition, the Group would have to repay any amounts received from HMT under the terms of APS. In consideration for the protection provided by the APS, the Group paid an initial premium of £1.4 billion on 31 December 2009. A further premium of £700 million was paid on 31 December 2010. Quarterly premiums of £125 million are payable from 31 December 2011 and subsequently until the earlier of 31 December 2099 and the termination of the agreement.

Losses are recognised when a covered asset has experienced a trigger event which comprises of failure to pay subject to grace periods, bankruptcy and restructuring.

APS assets are spread across the Group's main divisions. High volume commercial and retail exposures were selected on a portfolio basis where assets were high risk and in arrears at 31 December 2008. Large corporate and GBM exposures were selected at the counterparty/asset level based on individual risk reviews and defaulted assets in the workout/restructuring unit.

HMT has the right to appoint step-in managers to carry out any oversight, management or additional functions on behalf of HMT to ensure that the covered assets are managed and administered in compliance with the agreed terms and conditions. This right is exercisable if certain step-in triggers occur. These include:

- losses on covered assets in total exceed 125% of the first loss amount or losses on an individual covered asset class exceed specified thresholds;
- a breach of specified obligations in the APS rules or the accession agreement;
- the Group has failed or is failing to comply with any of the conditions in the APS rules in relation to asset management, monitoring and reporting, and governance and oversight, and such failure is persistent and material or it is evidence of a systematic problem; and
- material or systematic data deficiencies in the information provided to HMT in accordance with the terms of the APS.

HMT may at any time elect to cease to exercise its step-in rights in whole or part when it is satisfied that the step-in triggers have been remedied.

Appendix 2 The Asset Protection Scheme continued

Covered assets: roll forward to 31 December 2010

The table below details the movement in covered assets.

	£bn
Covered assets at 1 January 2009	282.0
Disposals	(3.0)
Non-contractual early repayments	(8.9)
Maturities and amortisation	(26.1)
Rollovers and covered amount cap adjustments	(1.7)
Effect of foreign currency movements and other adjustments	(11.8)
Covered assets at 31 December 2009	230.5
Disposals	(9.7)
Maturities, amortisation and early repayments	(28.7)
Reclassified assets (2)	3.1
Withdrawals	(2.9)
Effect of foreign currency movements and other adjustments	2.4
Covered assets at 31 December 2010	194.7

Notes:

- (1) The Asset Protection Agency (APA) and the Group have now reached agreement on substantially all eligibility issues.
- (2) In Q2 2010, the APA and the Group reached agreement over the classification of some structured credit assets which resulted in adjustments to the covered amount, without affecting the underlying risk protection.

Key points

- The reduction in covered assets was due to run-off of the portfolio, disposals, early repayments and maturing loans.
- As part of the Group's risk reduction strategy significant disposals were made from the Structured Credit Portfolio (2010 - £3.0 billion). The Group took advantage of market conditions and executed sales from its derivative, loan and leveraged finance portfolios (2010 - £6.7 billion).

Credit impairments and write downs

The table below analyses the cumulative credit impairment losses and adjustments to par value (including AFS reserves) relating to the covered assets.

	2010 £m	2009 £m
Loans and advances	18,033	14,240
Debt securities	11,747	7,816
Derivatives	2,043	6,834
	31,823	28,890
By division:		
UK Retail	2,964	2,431
UK Corporate	1,382	1,007
Ulster Bank	804	486
Retail & Commercial	5,150	3,924
Global Banking & Markets	1,496	1,628
Core	6,646	5,552
Non-Core	25,177	23,338
	31,823	28,890

Key points

- The increase in Non-Core impairments of £1.8 billion accounted for the majority of the increase in credit impairments and write downs in 2010.
- The APA and the Group reached agreement for the purposes of the Scheme, on the classification of some structured credit assets which has resulted in adjustments to credit impairments and write downs mainly between debt securities and derivatives.
- The reduction in Global Banking & Markets is largely a result of transfers to Non-Core in the second half of the year.

Appendix 2 The Asset Protection Scheme *continued*

First loss utilisation

The triggered amount is equivalent to the aggregate outstanding principal amount on the trigger date excluding interest, fees, premium or any other non-principal sum that is accrued or payable, except where it was capitalised on or before 31 December 2008. At the trigger date, in economic terms, there is an exchange of assets, with the Group receiving a two year interest-bearing government receivable in exchange for the asset.

APS recoveries include any return of value on a triggered asset, although these are only recognised for the Scheme reporting purposes when they are realised in cash. The net triggered amount at any point in time only takes into account cash recoveries to date. As with any bespoke and highly complex legal agreement there are various areas of interpretation, some of which could have a material impact on the net triggered amount identified to date.

The Scheme rules are designed to allow for data correction over the life of the Scheme.

The table below summarises the triggered amount and related cash recoveries by division.

	2010			2009		
	Triggered amount £m	Cash recoveries to date £m	Net triggered amount £m	Triggered amount £m	Cash recoveries to date £m	Net triggered amount £m
UK Retail	3,675	455	3,220	3,340	129	3,211
UK Corporate	4,640	1,115	3,525	3,570	604	2,966
Ulster Bank	1,500	160	1,340	704	47	657
Retail & Commercial	9,815	1,730	8,085	7,614	780	6,834
Global Banking & Markets	2,547	749	1,798	1,748	108	1,640
Core	12,362	2,479	9,883	9,362	888	8,474
Non-Core	32,138	4,544	27,594	18,905	777	18,128
	44,500	7,023	37,477	28,267	1,665	26,602
Loss credits			1,241			—
			38,718			26,602

Note:

- (1) The triggered amount on a covered asset is calculated when an asset is triggered (due to bankruptcy, failure to pay after a grace period or restructuring with an impairment) and is the lower of the covered amount and the outstanding amount for each covered asset. The Group expects additional assets to trigger upon expiry of relevant grace periods based on the current risk rating and level of impairments on covered assets.
- (2) Following the reclassification of some structured credit assets from derivatives to debt securities, the APA and the Group also reached agreement on an additional implied write down trigger in respect of these assets. This occurs if (a) on two successive relevant payment dates, the covered asset has a rating of Caa2 or below by Moody's, CCC or below by Standard & Poor's or Fitch or a comparable rating from an internationally recognised credit rating agency and/or (b) on any two successive relevant payment dates, the mark-to-market value of the covered asset is equal to or less than 40 per cent of the par value of the covered asset, in each case as at such relevant payment date.
- (3) Under the Scheme rules, the Group may apply to the APA for loss credits in respect of the disposal of non-triggered assets. A loss credit counts towards the first loss threshold and is typically determined by the APA based on the expected loss of the relevant asset.
- (4) The Group and the APA remain in discussion with regard to loss credits in relation to the withdrawal of £2.0 billion of derivative assets during Q2 2010 and the disposal of approximately £1.6 billion of structured finance and leveraged finance assets in 2010.
- (5) The Scheme rules contain provision for on-going revision of data.

Key points

- The Group received loss credits in relation to some of the withdrawals and disposals of £1.2 billion in 2010.
- The Group currently expects recoveries on triggered amounts to be approximately 45% over the life of the relevant assets. On this basis, the expected loss on triggered assets at 31 December 2010 is approximately £25 billion (42%) of the £60 billion first loss threshold under APS.

Appendix 2 The Asset Protection Scheme *continued*

Risk-weighted assets

The table below analyses by division, risk-weighted assets (RWAs) covered by APS.

	2010	2009
	£bn	£bn
UK Retail	12.4	16.3
UK Corporate	22.9	31.0
Ulster Bank	7.9	8.9
Retail & Commercial	43.2	56.2
Global Banking & Markets	11.5	19.9
Core	54.7	76.1
Non-Core	50.9	51.5
APS RWAs	105.6	127.6

Key points

- The decrease of £22.0 billion in RWAs reflects disposals and early repayments as well as changes in risk parameters.
- In Non-Core, disposals and early repayments were offset by changes in risk parameters.