



## Annual Report and Accounts

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# Board of directors and secretary

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## Chairman

Philip Hampton  
Nominations (Chair), RCR

## Executive directors

Ross McEwan  
Nathan Bostock

## Independent non-executive directors

Sandy Crombie  
Senior Independent Director  
Sustainability (Chair), Nominations, RCR, Remuneration, Risk

Alison Davis  
Nominations, Remuneration, Sustainability

Tony Di Iorio  
Audit, Nominations, Risk

Robert Gillespie  
Nominations

Penny Hughes  
Remuneration (Chair), Nominations, Sustainability

Brendan Nelson  
Audit (Chair), Nominations, RCR, Risk

Baroness Noakes  
Audit, Nominations, Risk

Philip Scott  
RCR (Chair), Risk (Chair), Audit, Nominations

## Secretary and Head of Corporate Governance

Aileen Taylor

## Auditors

Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Hill House  
1 Little New Street  
London EC4A 3TR

## Registered office

36 St Andrew Square  
Edinburgh EH2 2YB  
Telephone: +44 (0)131 556 8555

## Head office

PO Box 1000  
Gogarburn  
Edinburgh EH12 1HQ  
Telephone +44 (0)131 626 0000

## The Royal Bank of Scotland plc

Registered in Scotland No. SC90312

|                |                                                            |
|----------------|------------------------------------------------------------|
| Audit          | member of the Group Audit Committee                        |
| Nominations    | member of the Group Nominations Committee                  |
| RCR            | member of the RCR Board Oversight Committee                |
| Remuneration   | member of the Group Performance and Remuneration Committee |
| Risk           | member of the Board Risk Committee                         |
| Sustainability | member of the Group Sustainability Committee               |

## Presentation of information

In the Report and Accounts, and unless specified otherwise, the terms 'the Royal Bank', 'RBS plc' or 'the Bank' mean The Royal Bank of Scotland plc, the 'Group' means the Bank and its subsidiaries, 'RBSG' or the 'holding company' mean The Royal Bank of Scotland Group plc, 'RBS Group' means the holding company and its subsidiaries, and 'NatWest' means National Westminster Bank Plc.

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

The geographic analysis in the Business Review, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have generally been compiled on the basis of location of office - UK and overseas - unless indicated otherwise. 'UK' in this context includes transactions conducted through the offices in the UK which service international banking transactions.

### International Financial Reporting Standards

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

### Revised allocation of Business Services costs

In 2013, the Group reclassified certain costs between direct and indirect expenses for all divisions. Comparatives have been restated accordingly; the revision did not affect total expenses or operating profit.

### Implementation of IAS 19 'Employee Benefits' (revised)

The RBS Group implemented IAS 19 with effect from 1 January 2013. IAS 19 requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £84 million for the year ended 31 December 2012 and £151 million for the year ended 31 December 2011. Prior periods have been restated accordingly.

### Glossary

A glossary of terms is provided on pages 347 to 353.

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## Financial review

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### Description of business

#### Introduction

The Royal Bank of Scotland plc is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc, a large banking and financial services group. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

Following the placing and open offers in December 2008 and in April 2009, HM Treasury owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HM Treasury. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HM Treasury's holding of ordinary shares of the holding company remained at 70.3% although its economic interest rose to 84.4%.

At 31 December 2013, HM Treasury's holding of ordinary shares in the holding company was 63.9% and its economic interest was 80.2%.

#### Organisational structure and business overview

The Group's activities during 2013 were organised on a divisional basis as follows:

*UK Retail* offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile. UK Retail is committed to serving customers well, making banking easier and convenient whilst ensuring that we do business in an open, honest and sustainable manner.

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

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

*International Banking* serves the world's largest companies with a leading client proposition focused on financing, risk management and transaction services. It serves as the delivery channel for Markets products to international corporate clients. The division also serves international subsidiaries of clients from other RBS Group divisions (e.g. UK Corporate, Ulster Bank and US Retail & Commercial) through its international network.

*Ulster Bank* is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

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

In February 2013, the RBS Group announced that it would commence work on a partial flotation of RBS Citizens and in November 2013 confirmed that a partial initial public offering is now planned for 2014. The Group intends to fully divest the business by the end of 2016.

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

*Markets* is a leading origination, sales and trading business across debt finance, fixed income and currencies. The division offers a unified service to the Group's corporate and institutional clients. The Markets' origination, sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division's trading and structuring teams to meet the client's objectives across financing, risk management, investment, securitisation and liquidity.

A new strategy for the Markets division was announced in June 2013 enabling RBS to concentrate on its core customers' needs where the Markets business is strongest. Markets is now focused on our core fixed income capabilities across rates, foreign exchange, asset backed products, credit and debit capital markets, while de-emphasising some more capital intensive structured product areas.

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

*Non-Core Division* managed separately assets that the Group intended to run off or dispose of. The division contained a range of businesses and asset portfolios primarily from the legacy GBM businesses, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also included a number of other portfolios and businesses including regional markets businesses that the Group had concluded were no longer strategic.

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## Financial review

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### Description of business continued

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

### Business divestments

To comply with the European Commission State Aid requirements the RBS Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These include the divestment of Direct Line Insurance Group plc, the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK ("UK branch-based businesses").

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the RBS Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales and 6 NatWest branches in Scotland. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985.

### RBS Capital Resolution (RCR)

In response to a recommendation by the Parliamentary Commission on Banking Standards, the RBS Group worked closely with HM Treasury (HMT) and its advisers on a 'good bank/bad bank' review and identified a pool of c.£38 billion of assets with particularly high long-term capital intensity, credit risk and/or potentially volatile outcomes in stressed environments.

The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified and consequently the RBS Group decided to create an internal 'bad bank', RBS Capital Resolution (RCR), to manage these assets down so as to release capital. RCR brings assets under common management and increases focus on the run down.

RCR became fully operational on 1 January 2014 with a pool of c.£29 billion of assets (of which £27.3 billion related to the Group) down from the forecast of c.£38 billion due to accelerated disposals and increased impairments. Whilst RCR is of a similar size to the Non-Core division, the assets have been selected on a different basis and no direct comparisons can be drawn.

### Strategic review

In November 2013, the RBS Group announced that it was undertaking a comprehensive business review of its: Customer-facing business, IT and operations and Organisational and decision making structures

The aim of the review is to improve the bank's performance and effectiveness in serving its customers, shareholders and wider stakeholders.

On 27 February 2014, the RBS Group announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved resilience.

### Moody's Investors Service

On 13 March 2014, Moody's closed a second ratings review, first initiated on 12 February 2014, on RBS Group by lowering the credit ratings of RBSG and certain subsidiaries by one notch. The long term ratings of RBSG was lowered to 'Baa2' from 'Baa1' whilst the long term ratings of RBS plc and National Westminster Bank Plc were lowered to 'Baa1' from 'A3'. Short term ratings were affirmed as unchanged. Post the review, the ratings outlook assigned was negative.

The ratings of Ulster Bank Ltd and Ulster Bank Ireland Ltd's were impacted by the rating action on the RBS Group. Moody's lowered its long term and short term ratings of these entities by 1-notch to 'Baa3' (long term)/'P-3' (short term) from 'Baa2'/'P-2'. A negative outlook was assigned to ratings, in line with the outlook on the RBS Group.

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## Financial review

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### Competition

The Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand remains subdued as many customers continue to deleverage even as the UK economy begins to show signs of recovery. Competition for retail deposits has eased somewhat as institutions have made progress towards building strong and diverse funding platforms for their balance sheets.

Competition for corporate and institutional customers in the UK and abroad is from UK banks and from large foreign universal banks that offer combined investment and commercial banking capabilities. In addition, the Group's Markets division faces strong competition from dedicated investment banks. In asset finance, the Group competes with banks and specialist asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets the Group competes with the large domestic banks active in these markets and with the major international banks.

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

In the personal banking segment, the Group competes with UK clearing banks and building societies, major retailers and life assurance companies. In the mortgage market, the Group competes with UK clearing banks and building societies. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms by acquiring businesses made available through restructuring of incumbents.

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

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

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

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

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## Financial review

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### Risk factors

#### Summary of our Principal Risks and Uncertainties

Set out below is a summary of certain risks which could adversely affect the Group; it should be read in conjunction with the Risk and balance sheet management section on pages 28 to 195. This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 331 to 346.

- The RBS Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of its efforts to refocus on its core strengths and the timely divestment of RBS Citizens. The RBS Group has undertaken since 2009 an extensive restructuring, including the disposal of non-core assets as well as businesses as part of the State Aid restructuring plan approved by the EC. The RBS Group recently created RBS Capital Resolution Group (CRG) to manage the run down of problem assets with the goal of removing such assets from the balance sheet over the next three years. The RBS Group has also taken steps to strengthen its capital position and established medium term targets which will require the timely divestment of RBS Citizens to achieve. The RBS Group is also undertaking a new strategic direction which will result in a significant downsizing of the RBS Group, including simplifying the RBS Group by replacing the current divisional structure with three customer segments. The level of structural change required to implement the RBS Group's strategic and capital goals together with other regulatory requirements such as ring fencing are likely to be disruptive and increase operational risks for the RBS Group. There is no assurance that the RBS Group will be able to successfully implement its new strategy on which its capital plan depends or achieve its goals within the time frames contemplated or at all.
- Despite the improved outlook for the global economy over the near to medium-term, actual or perceived difficult global economic conditions and increased competition, particularly in the UK, create challenging economic and market conditions and a difficult operating environment for the RBS Group's businesses. Uncertainties surrounding the referendum on Scottish independence and the implications of an affirmative outcome for independence are also likely to affect the RBS Group. These factors, together with additional uncertainty relating to the recovery of the Eurozone economy where the RBS Group has significant exposure and the risk of a return of volatile financial markets, in part due to the monetary policies and measures carried out by central banks, have been and will continue to adversely affect the Group's businesses, earnings, financial condition and prospects.
- The RBS Group is subject to substantial regulation and oversight, and any significant regulatory or legal developments such as that which has occurred over the past several years could have an adverse effect on how the Group conducts its business and on its results of operations and financial condition. Certain regulatory measures introduced in the UK and in Europe relating to ring-fencing of bank activities may affect the Group's borrowing costs, may impact product offerings and the viability of certain business models and require significant restructuring with the possible transfer of a large number of customers between legal entities.
- The RBS Group could fail to attract or retain senior management, which may include members of the RBS Group Board, or other key employees, and it may suffer if it does not maintain good employee relations.
- The RBS Group is subject to a number of regulatory initiatives which may adversely affect its business, including the UK Government's adoption of the Financial Services (Banking Reform) Act 2013, the US Federal Reserve's new rules for applying US capital, liquidity and enhanced prudential standards to certain of the RBS Group's US operations and ongoing reforms in the European Union with respect to capital requirements, stability and resolution of financial institutions, including CRD IV and other currently debated proposals such as the Resolution and Recovery Directive (RRD).
- The RBS Group's ability to meet its obligations including its funding commitments depends on the RBS Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise or to do so at a reasonable cost due to increased regulatory constraints, could adversely affect the Group's financial condition and results of operations. Furthermore, the RBS Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings which would be likely to be negatively impacted by political events, such as an affirmative outcome of the referendum for the independence of Scotland.
- The RBS Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements, including those arising out of Basel III implementation (globally or by European, UK or US authorities) as well as structural changes that may result from the implementation of ring-fencing under the Financial Services (Banking Reform) Act 2013 or proposed changes of the US Federal Reserve with respect to the RBS Group's US operations. The Group's ability to reach its target capital ratios in the medium term will turn on a number of factors including a significant downsizing of the Group in part through the sale of RBS Citizens.
- The RBS Group is, and may be, subject to litigation and regulatory and governmental investigations that may impact its business, reputation, results of operations and financial condition. Although the RBS Group settled a number of legal proceedings and regulatory investigations during 2013, the RBS Group is expected to continue to have a material exposure to legacy litigation and regulatory matter proceedings in the medium term. The RBS Group also expects greater regulatory and governmental scrutiny for the foreseeable future particularly as it relates to compliance with new and existing laws and regulations such as anti-money laundering and anti-terrorism laws.
- Operational and reputational risks are inherent in the RBS Group's businesses.



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## Financial review

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### Risk factors continued

- The RBS Group is highly dependent on its information technology systems and has been and will continue to be subject to cyber attacks which expose the RBS Group to loss of customer data or other sensitive information, and combined with other failures of the RBS Group's information technology systems, hinder its ability to service its clients which could result in long-term damage to the RBS Group's business and brand.
- RBSG or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures, including recapitalisation of RBSG or any of its UK bank subsidiaries, through bail-in which has been introduced by the Financial Services (Banking Reform) Act 2013 and will come into force on a date stipulated by HM Treasury. These various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the RBS Group's businesses.
- As a result of the UK Government's majority shareholding in RBSG it may be able to exercise a significant degree of influence over the RBS Group including on dividend policy, the election of directors or appointment of senior management or limiting the RBS Group's operations. The offer or sale by the UK Government of all or a portion of its shareholding in RBSG could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of RBSG from the Official List.
- The actual or perceived failure or worsening credit of the RBS Group's counterparties or borrowers, including sovereigns in the Eurozone, and depressed asset valuations resulting from poor market conditions have led the RBS Group to realise and recognise significant impairment charges and write-downs which have adversely affected the RBS Group and could continue to adversely affect the RBS Group if, due to a deterioration in economic and financial market conditions or continuing weak economic growth, it were to recognise or realise further write-downs or impairment charges.
- The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate.
- Recent developments in regulatory or tax legislation and any further significant developments could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the Group is subject to uncertainty.
- The RBS Group is required to make planned contributions to its pension schemes and to compensation schemes in respect of certain financial institutions, either of which, independently or in conjunction with additional or increased contribution requirements may have an adverse impact on the Group's results of operations, cash flow and financial condition.

## Financial review

### Financial summary

#### Summary consolidated income statement for the year ended 31 December 2013

|                                            | 2013<br>£m | 2012*<br>£m |
|--------------------------------------------|------------|-------------|
| Net interest income                        | 10,594     | 10,632      |
| Fees and commissions receivable            | 5,380      | 5,558       |
| Fees and commissions payable               | (911)      | (963)       |
| Income from trading activities             | 2,974      | 1,511       |
| Gain on redemption of own debt             | 162        | 454         |
| Other operating income                     | 1,576      | 1,296       |
| Non-interest income                        | 9,181      | 7,856       |
| Total income                               | 19,775     | 18,488      |
| Operating expenses                         | (18,087)   | (16,798)    |
| Profit before impairment losses            | 1,688      | 1,690       |
| Impairment losses                          | (8,449)    | (5,214)     |
| Operating loss before tax                  | (6,761)    | (3,524)     |
| Tax charge                                 | (503)      | (336)       |
| Loss for the year                          | (7,264)    | (3,860)     |
| Non-controlling interests                  | 13         | (19)        |
| Preference dividends                       | (58)       | (58)        |
| Loss attributable to ordinary shareholders | (7,309)    | (3,937)     |

\*Restated – see page 3

#### Operating loss

Operating loss before tax was £6,761 million compared with £3,524 million in 2012 driven largely by additional charges for regulatory and legal actions and higher impairment losses primarily reflecting increased provisions in connection with the creation of RBS Capital Resolution (RCR)<sup>(1)</sup>. These were partially offset by a lower accounting charge for improved own credit.

#### Net interest income

Net interest income decreased by £38 million to £10,594 million, with deposit pricing initiatives only partly mitigating the impact of lower interest-earning assets, which reflected reductions in Markets and Non-Core loans and advances to customers as well as strategic sale and run-down of debt securities.

#### Non-interest income

Non-interest income increased by £1,325 million, 17% to £9,181 million compared with £7,856 million in 2012 primarily due to the lower accounting charge for improved own credit of £25 million (2012 - £3,904 million). This was partially offset by a lower gain on redemption of own debt of £162 million (2012 - £454 million), a fall in operating lease and other rental income of £393 million, a decrease in net gains on sale of securities of £768 million and a charge of £333 million reflecting asset valuation adjustments related to the establishment of RCR.

#### Operating expenses

Operating expenses increased by £1,289 million, 8% to £18,087 million compared with £16,798 million in 2012. This was principally due to charges of £2,394 million (2012 - £381 million) for regulatory and legal actions, primarily in respect of matters related to mortgage-backed securities and securities related litigation following recent third party litigation settlements and regulatory decisions, and write-down of goodwill and other intangible assets of £423 million (2012 - £51 million). These were partially offset by lower staff costs, down £579 million to £7,006 million reflecting lower headcount, Payment Protection Insurance costs, down £210 million to £900 million, and lower costs in relation to Interest Rate Hedging Products redress and related costs, down £150 million to £550 million.

#### Impairment losses

Impairment losses increased by £3,235 million to £8,449 million primarily reflecting the increased provisions recognised in connection with the creation of RCR, which was set up from 1 January 2014. Excluding the impact of the creation of RCR of £4,488 million, impairment losses decreased by £1,253 million to £3,961 million driven by significant improvements in Non-Core, Ulster Bank and UK Retail partially offset by increases in International Banking, US Retail & Commercial and Markets.

#### Capital ratios

Capital ratios at 31 December 2013 were 9.8% (Core Tier 1), 11.4% (Tier 1) and 17.4% (Total).

Note:

(1) During the year the Group recognised £4,821 million of impairment and other losses related to the establishment of RCR. This comprises impairment losses of £4,488 million (of which £173 million relate to core Ulster Bank assets which were not transferred to RCR but are subject to the same strategy) and £333 million reduction in income reflecting asset valuation adjustments.

## Financial review

### Divisional performance

The results of each division on a managed basis are set out below. The results are stated before movements in own credit adjustments, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs, regulatory and legal actions, integration and restructuring costs, gain on redemption of own debt, write-down of goodwill and other intangible assets, Asset Protection Scheme, amortisation of purchased intangible assets, strategic disposals, bank levy and bonus tax.

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

| Operating profit/(loss) by division                      | 2013<br>£m | 2012*<br>£m |
|----------------------------------------------------------|------------|-------------|
| UK Retail                                                | 2,116      | 2,095       |
| UK Corporate                                             | 1,106      | 1,865       |
| Wealth                                                   | 274        | 314         |
| International Banking                                    | 419        | 645         |
| Ulster Bank                                              | (1,428)    | (1,011)     |
| US Retail & Commercial                                   | 720        | 860         |
| Retail & Commercial                                      | 3,207      | 4,768       |
| Markets                                                  | 686        | 1,505       |
| Central items                                            | (1,461)    | (1,613)     |
| Core                                                     | 2,432      | 4,660       |
| Non-Core                                                 | (4,402)    | (1,191)     |
| Operating (loss)/profit                                  | (1,970)    | 3,469       |
| Own credit adjustments                                   | (25)       | (3,904)     |
| Payment Protection Insurance costs                       | (900)      | (1,110)     |
| Interest Rate Hedging Products redress and related costs | (550)      | (700)       |
| Regulatory and legal actions                             | (2,394)    | (381)       |
| Integration and restructuring costs                      | (587)      | (1,226)     |
| Gain on redemption of own debt                           | 162        | 454         |
| Write-down of goodwill and other intangible assets       | (423)      | (51)        |
| Asset Protection Scheme                                  | —          | (44)        |
| Amortisation of purchased intangible assets              | (35)       | (41)        |
| Strategic disposals                                      | 161        | 185         |
| Bank levy                                                | (200)      | (175)       |
| Operating loss before tax                                | (6,761)    | (3,524)     |

\*Restated - see page 3.

The performance of each division is reviewed on pages 11 to 24.

## Financial review

### UK Retail

|                                              | 2013<br>£m | 2012<br>£m |
|----------------------------------------------|------------|------------|
| Net interest income                          | 4,057      | 4,084      |
| Net fees and commissions                     | 906        | 911        |
| Other non-interest income                    | (8)        | (7)        |
| Non-interest income                          | 898        | 904        |
| Total income                                 | 4,955      | 4,988      |
| Direct expenses                              |            |            |
| - staff                                      | (707)      | (798)      |
| - other                                      | (541)      | (352)      |
| Indirect expenses                            | (1,267)    | (1,214)    |
|                                              | (2,515)    | (2,364)    |
| Operating profit before impairment losses    | 2,440      | 2,624      |
| Impairment losses                            | (324)      | (529)      |
| Operating profit                             | 2,116      | 2,095      |
|                                              | £bn        | £bn        |
| Balance sheet                                |            |            |
| Loans and advances to customers (gross)      |            |            |
| - mortgages                                  | 99.3       | 99.1       |
| - personal                                   | 8.1        | 8.8        |
| - cards                                      | 5.8        | 5.7        |
|                                              | 113.2      | 113.6      |
| Loan impairment provisions                   | (2.1)      | (2.6)      |
| Net loans and advances to customer           | 111.1      | 111.0      |
| Customer deposits                            | 114.9      | 107.6      |
| Assets under management (excluding deposits) | 5.8        | 6.0        |

In March 2013 UK Retail announced its strategy to become a simpler and more customer-focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Good progress has been made with £180 million of investment during 2013 through a number of initiatives directed at enhancing customer service and simplification of products and services. These have included:

- Improvements to Mobile and Digital Banking which continue to evolve in line with how customers prefer to conduct their business. One example of this is the enhancements in the mobile application allowing customers to pay their mobile phone contacts and obtain cash without using their debit card with the award winning 'Get Cash'. Investment in digital products and services continued in 2013, with 50% of eligible customers now banking online or on mobile. We currently have 5.6 million online users and 2.9 million customers using our mobile app with over 100 million transactions made in 2013. Branch counter transactions were 31 million or 11% lower across the same period. In addition, UK Retail now has over 2.5 million active mobile users, using the service 28 times a month on average. Mobile net promoter scores continued to increase in 2013.
- During the year UK Retail invested in the introduction of a new integrated telephony system, increased training and the professional development of our staff. We spent more time on each call to support excellent customer service and to promote relevant offerings, including self service.
- During Q1 2013 mortgage advisors attended extensive training courses to help ensure customers receive the best possible outcome to meet their needs. The training affected balance growth during H1 2013; however, application volumes have rebounded quickly with the launch of competitively priced products and the 'NatYes' and 'RBYES' advertising campaigns leading to H2 2013 applications being 30% higher than H1 2013. RBS was the first bank to be ready to deliver the second phase of the UK Government's Help To Buy scheme, launched in early October 2013. Extended opening hours in branches helped to deliver more than 3,000 approvals assisting young people and families across Britain buy their home. Gross mortgage lending increased 3% year-on-year to £14.3 billion with Q4 2013 25% higher than Q4 2012.

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## Financial review

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### UK Retail continued

- Significant focus on streamlining processes has benefited all distribution channels, with the capacity created allowing more time for staff coaching and resulting in advisors spending more time and having better conversations with customers.
- In addition, our product range has been simplified down from 56 to 46 with several products winning awards. A highlight of this UK Retail strategy is the success of the new instant saver product launched in Q4 2012, which at the end of 2013 had more than £10 billion in balances. Furthermore, nearly 800,000 customers have registered for Cashback Plus online since launch in Q3 2013 and are being rewarded for using their debit cards with selected retailers.
- A major branch refurbishment programme is under way with over one quarter completed. 350 branches now have a digital banking zone where customers can use in-branch technology to access online banking. Wi-Fi in-branch allows customers to access their account via their own devices.

During 2013 good progress has been made with FCA (Financial Conduct Authority) reportable complaints, which declined 22%. In addition, the provision relating to historic Payment Protection Insurance (PPI) mis-selling was increased by £860 million, bringing the total to £3.0 billion. The PPI expense is not included in the operating profit of UK Retail.

In 2014, UK Retail will aim to maintain a leading position in digital banking, launching new capability and customer proposition through mobile devices.

### 2013 compared with 2012

Operating profit increased by 1% to £2,116 million driven by a 39% decline in impairment losses. Net interest income was 1% lower with growth in mortgage income more than offset by a decline in deposit margins. Investment advice fee income was adversely impacted following changes introduced by the Retail Distribution Review (RDR). Costs increased primarily because of a higher FSCS levy and other regulatory charges totalling £116 million in the year, conduct-related provisions of £63 million and additional technology investment of £45 million.

Mortgage balance growth was affected in H1 2013 by mortgage advisor training; however, balances recovered during H2 2013 assisted by early adoption of the second phase of the UK Government's Help To Buy scheme. Gross lending increased to £8.9 billion in H2 2013. Customer deposits increased by 7%, above the UK market average of 4% due to strong growth in both current accounts (13%) and instant access savings accounts (15%).

Net interest income fell 1% to £4,057 million.

- Mortgage new business margins reduced in line with market conditions; however, overall book margins improved.
- Deposit margins declined reflecting the impact of continued lower rates on current account hedges. Savings margins, however, have increased over 2013 with improved market pricing.

Non-interest income fell by 1% to £898 million due to subdued advice fee income post RDR.

Direct costs increased by 9% due to higher FSCS levy and other regulatory charges and conduct-related provisions of £63 million. This was partly offset by lower staff costs due to a reduction in headcount of 2,200. Indirect costs increased by 4%, largely due to investment in technology.

Impairments declined by 39% to £324 million due to lower customer defaults across all products reflecting continued improvement in asset quality.

## Financial review

### UK Corporate

|                                           | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|------------|------------|
| Net interest income                       | 2,757      | 2,891      |
| Net fees and commissions                  | 1,309      | 1,365      |
| Other non-interest income                 | 284        | 383        |
| Non-interest income                       | 1,593      | 1,748      |
| Total income                              | 4,350      | 4,639      |
| Direct expenses                           |            |            |
| - staff                                   | (912)      | (940)      |
| - other                                   | (442)      | (363)      |
| Indirect expenses                         | (702)      | (633)      |
|                                           | (2,056)    | (1,936)    |
| Operating profit before impairment losses | 2,294      | 2,703      |
| Impairment losses (1)                     | (1,188)    | (838)      |
| Operating profit                          | 1,106      | 1,865      |
|                                           | £bn        | £bn        |
| Balance sheet                             |            |            |
| Loans and advances to customers (gross)   | 102.5      | 107.0      |
| Loan impairment provisions                | (2.8)      | (2.4)      |
| Net loans and advances to customer        | 99.7       | 104.6      |
| Customer deposits                         | 124.7      | 127.1      |

Note:

(1) Includes £410 million pertaining to the creation of RCR and related strategy.

2013 was a year in which UK Corporate underlined its commitment to support the UK economy and played an active role in the communities it operates in.

As part of this commitment the Bank appointed Sir Andrew Large to undertake a thorough and independent review of the lending standards and practices used by RBS and NatWest. UK Corporate will implement all of the Independent Lending Review's recommendations and is adopting a revised strategy and capabilities to enhance support to SMEs and the wider UK economic recovery while maintaining sound lending practices.

As part of the division's concerted effort to support its SME customers, UK Corporate has been proactively reviewing the business needs of SME customers to understand if they could benefit from the offer of additional facilities. In 2013, over 12,000 customers were identified for additional funding under UK Corporate's 'Statements of Appetite' initiative. The initiative resulted in approximately £6 billion of new funding being offered to customers.

The division has continued to support the government-backed Funding for Lending Scheme (FLS) and as at 31 December 2013 had allocated in excess of £4.7 billion of new FLS-related lending to almost 25,000 customers, £3.1 billion of which has been drawn since the scheme was launched. Mid-sized manufacturers are being offered targeted support, with interest rates reduced by more than 1% in some cases. SME customers benefited from both lower interest rates and the removal of arrangement fees.

As well as delivering a range of lending initiatives, UK Corporate continued to develop new propositions for its customers. Following a successful pilot UK Corporate launched a leading business-to-business online community platform, Bizcrowd, to support independent needs matching. By the end of 2013 Bizcrowd had over 27,000 users and is now helping to bring businesses together across the UK.

During the course of 2013 UK Corporate's Business Banking Enterprise Programme helped over 40,000 entrepreneurs through over 1,000 events. Through its combination of nationwide start-up surgeries, mobile business schools and business academies, the programme offers support and advice to aspiring entrepreneurs, new start-up businesses and established SMEs looking to grow. Combined with UK Corporate's skills-based volunteering scheme, a programme offering all employees five days to volunteer with a charitable organisation, UK Corporate continued to deliver on its on-going commitment to communities.

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## **Financial review**

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### **UK Corporate** continued **2013 compared with 2012**

Net interest income was 5% lower at £2,757 million, as increased income from re-pricing initiatives was offset by the lower rate environment impacting deposit returns, the non-repeat of 2012 deferred income recognition revisions (£58 million) and reduced lending volumes, as loan repayments coupled with run-off in property and shipping sectors outpaced new lending.

Non-interest income reduced 9% to £1,593 million, primarily from lower Markets revenue share income, a decline in operating lease income (offset by an associated reduction of operating lease depreciation in expenses), lower lending fees and higher derivative close-out costs associated with impaired assets.

Expenses, increased 6% to £2,056 million, primarily as a result of remediation provisions of £68 million, an increased share of branch network costs and an uplift in investment spend. This was offset by the reduction in operating lease depreciation, a decline in Markets revenue share related costs and lower staff incentive expenditure.

Whilst full year impairments include the additional impact of increased impairment losses related to the creation of RCR (£410 million), underlying impairments improved by £60 million, or 7%, to £778 million due to lower individual and collectively assessed provisions in the SME business, partially offset by higher individual cases in the mid-to-large corporate business.

## Financial review

### Wealth

|                                              | 2013<br>£m | 2012<br>£m |
|----------------------------------------------|------------|------------|
| Net interest income                          | 683        | 740        |
| Net fees and commissions                     | 353        | 364        |
| Other non-interest income                    | 65         | 84         |
| Non-interest income                          | 418        | 448        |
| Total income                                 | 1,101      | 1,188      |
| Direct expenses                              |            |            |
| - staff costs                                | (402)      | (407)      |
| - other                                      | (123)      | (162)      |
| Indirect expenses                            | (273)      | (259)      |
|                                              | (798)      | (828)      |
| Operating profit before impairment losses    | 303        | 360        |
| Impairment losses                            | (29)       | (46)       |
| Operating profit                             | 274        | 314        |
|                                              | £bn        | £bn        |
| Balance sheet                                |            |            |
| Loans and advances to customers (gross)      |            |            |
| - mortgages                                  | 8.7        | 8.8        |
| - personal                                   | 5.6        | 5.5        |
| - other                                      | 2.5        | 2.8        |
|                                              | 16.8       | 17.1       |
| Loan impairment provisions                   | (0.1)      | (0.1)      |
| Net loans and advances to customer           | 16.7       | 17.0       |
| Customer deposits                            | 37.0       | 38.9       |
| Assets under management (excluding deposits) | 29.7       | 28.9       |

2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review (RDR). Clients welcomed Coutts' new fully compliant advice-led model where Coutts requires its advisers to achieve the more stringent Level 6 rating, in excess of the FCA's minimum Level 4 requirement. Coutts has received a number of industry accolades for its levels of service, such as 'UK Private Bank of the Year' (The Banker Global Private Banking Awards). Total assets under advice grew to approximately £3 billion over the year.

Following the deposit re-pricing strategy implemented in the second half of 2013 deposit margins have significantly improved. Lending volumes have remained resilient despite pay-downs in line with best-advice policy under RDR. In addition, a new international trust strategy was announced, strengthening the client offering by positioning it as a market-leading, client-centric trust business. This was achieved by the creation of a centre of excellence in Jersey, accompanied by withdrawal from the Cayman Islands and restructuring of the Geneva trust business.

Work continued on streamlining client-facing processes and driving increased benefits from the division's global technology platform, including significant enhancements to Coutts' online and digital client channels. A streamlining of the London property footprint from 11 buildings to 2 was also concluded, alongside further office rationalisation in the International business.

### 2013 compared with 2012

Operating profit was 13% lower at £274 million, driven by lower income partially offset by a decrease in expenses and impairment losses.

Income declined by 7% to £1,101 million, with the reduction in net interest income reflecting the lower spread earned on deposits as a result of lower Group funding requirements.

Non-interest income fell by 7% to £418 million due to the disposal of the Latin American, Caribbean and African businesses for a profit of £15 million in H1 2012 together with a decline in fee income in the International business.

Expenses were 4% lower at £798 million as a result of reduced headcount, tight discretionary cost management and the non-recurrence of two regulatory fines totalling £26 million incurred during 2012. This was partially offset by a one-off UK tax treaty charge in the International business.

Client assets and liabilities managed by the division declined by 2%, with a £1.9 billion reduction in deposits following re-pricing initiatives in the UK in line with the wider Group funding strategy. Assets under management increased by 3% due to positive market movements. Lending was 2% lower, reflecting increased levels of repayments in the UK.

Impairments were £17 million lower at £29 million, largely reflecting a small number of specific impairments.



## Financial review

### International Banking

|                                           | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|------------|------------|
| Net interest income                       | 725        | 797        |
| Non-interest income                       | 1,052      | 920        |
| Total income                              | 1,777      | 1,717      |
| Direct expenses                           |            |            |
| - staff                                   | (498)      | (491)      |
| - other                                   | (158)      | (143)      |
| Indirect expenses                         | (468)      | (307)      |
|                                           | (1,124)    | (941)      |
| Operating profit before impairment losses | 653        | 776        |
| Impairment losses (1)                     | (234)      | (131)      |
| Operating profit                          | 419        | 645        |
|                                           | £bn        | £bn        |
| Balance sheet                             |            |            |
| Total assets                              | 46.3       | 49.1       |
| Loans and advances                        | 34.1       | 39.0       |
| Customer deposits                         | 38.6       | 41.5       |

Note:

(1) Includes £52 million pertaining to the creation of RCR and related strategy.

International Banking provides for the needs of its customers through its offering of debt financing, risk management and transaction services across its network.

The strength of the division's efforts in serving its customers' needs is reflected in recent external industry awards and recognition, including:

- Best Trade Finance Bank, UK, and Best Supply Chain Finance Provider, Western Europe - Global Finance. Global Trade Review magazine's 'Leaders in Trade' award for Best Bank for Documentary Processing 2013, making this the 4th consecutive win for the bank.
- A good performance in the Euromoney 2013 Cash Management Survey, particularly in Europe, ranking #1 in the Netherlands, #2 in the UK and #2 in Western Europe. International Banking improved on last year's performance in APAC, achieving a #8 ranking, and retained a #9 ranking in North America and a #6 ranking globally.
- Received the 'Most Innovative Investment Bank for Loans' award at The Banker Investment Banking Awards 2013 providing a further indication that RBS is putting customers at the heart of its business.
- Best Debt House, UK - Euromoney.

### 2013 compared with 2012

Operating profit, decreased by £226 million as lower income and higher impairments, including £52 million in relation to the accelerated asset recovery strategy associated with RCR, were only partially offset by lower costs.

Income was 3% higher due to the migration of income from the transfer of assets from RBS N.V. Excluding this migration, revenue was down driven by smaller balance sheet and declining 3 month LIBOR rates.

Expenses increased by £183 million or 19% due to the migration of headcount and associated costs from the transfer of assets from RBS N.V. Excluding this migration, expenses were down reflecting continued emphasis on cost control and timely run off of discontinued business.

Impairment losses were £103 million higher than in 2012, including two large single-name provisions and £52 million in relation to the impact of the accelerated RCR asset recovery strategy.

Customer deposits declined by 7% in line with a change in Group funding strategy.

## Financial review

### Ulster Bank

|                                           | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|------------|------------|
| Net interest income                       | 619        | 634        |
| Net fees and commissions                  | 141        | 145        |
| Other non-interest income                 | 99         | 51         |
| Non-interest income                       | 240        | 196        |
| Total income                              | 859        | 830        |
| Direct expenses                           |            |            |
| - staff costs                             | (239)      | (214)      |
| - other                                   | (63)       | (49)       |
| Indirect expenses                         | (211)      | (214)      |
|                                           | (513)      | (477)      |
| Operating profit before impairment losses | 346        | 353        |
| Impairment losses (1)                     | (1,774)    | (1,364)    |
| Operating loss                            | (1,428)    | (1,011)    |
|                                           | £bn        | £bn        |
| Balance sheet                             |            |            |
| Loans and advances to customers (gross)   |            |            |
| - mortgages                               | 19.0       | 19.2       |
| - commercial real estate                  |            |            |
| - investment                              | 3.4        | 3.6        |
| - development                             | 0.7        | 0.7        |
| - other corporate                         | 7.1        | 7.8        |
| - other lending                           | 1.2        | 1.3        |
|                                           | 31.4       | 32.6       |
| Loan impairment provisions                | (5.4)      | (3.9)      |
| Net loans and advances to customer        | 26.0       | 28.7       |
| Customer deposits                         | 21.7       | 22.1       |

Note:

(1) Includes £892 million pertaining to the creation of RCR and related strategy.

The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. The creation of RCR resulted in additional charges of £911 million in Ulster Bank's results in Q4 2013.

Operating performance for 2013, excluding the impact of the creation of RCR, improved by £494 million or 49% versus prior year primarily reflecting higher income and a 64% reduction in mortgage impairment losses driven by enhanced collections effectiveness, the development of programmes to assist customers in financial difficulty and a modest improvement in economic conditions.

Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers. The bank made considerable progress during 2013 in its commitment to building a really good bank that serves customers well.

### Simplifying Banking

Ulster Bank delivered a number of improvements for personal and business customers in 2013:

- The launch of initiatives such as "Get Cash", "Pay Your Contacts" and "Emergency Cash" provided a new range of simple and convenient services for customers to access their cash and make payments online and via mobile.
- Further development of online and mobile banking for business customers focused on providing an efficient and effective day-to-day banking service. Enhancements during 2013 included a speedy and simplified account application process; registration for Anytime Banking via telephone; ability to manage personal and business accounts together and access to extended transaction history.
- The efficiency and effectiveness of Ulster Bank's digital offering was evidenced by a 55% increase in mobile app registrations and more than 100 million transactions were carried out via digital channels during 2013. Over 315,000 customers regularly use mobile app banking services and 640,000 customers make regular use of online Anytime banking services.

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## Financial review

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### Ulster Bank continued

#### Supporting Enterprise and the Community:

- Supporting entrepreneurship and the growth of small businesses in the local community is a long term commitment of Ulster Bank. Highlights in 2013 included:
  - The Community Impact Fund and Business Woman Can initiative which facilitated women in local communities to set up their own business. The bank also supported a number of projects in schools across the island of Ireland through its MoneySense programme.
  - Ulster Bank's dedicated SME teams offer professional support and a range of products to help customers meet their banking challenges and grow their business. The agri-specialist team has introduced a number of initiatives during 2013 to support the farming sector.
  - The 'One Week in June' initiative raised £430,000 for a number of Irish charities through a series of fundraising events involving both customers and staff.
  - In partnership with Concern Worldwide and Disasters Emergency Committee, Ulster Bank ATMs, branches and online banking facilitated donations to the Philippines Typhoon emergency appeals.

#### Helping Customers out of Financial Difficulty:

- Ulster Bank is committed to working with all customers in financial difficulty to find a solution. The Bank continued to invest in its Problem Debt Management Unit and further developed a range of solutions to make it easier for customers to enter into arrangements. As a consequence, the number of mortgage customers in arrears of 90 days or more has decreased every month since March 2013.

### 2013 compared with 2012

Excluding the impact of the creation of RCR, operating result improved by £494 million or 49% primarily due to a higher income and lower impairment losses on the mortgage portfolio.

Total income increased by £29 million or 3% to £859 million primarily reflecting hedging gains on the mortgage portfolio. Net interest income was £15 million lower at £619 million, largely driven by lower interest-earning assets and a higher cost of funding.

Total expenses increased by £36 million or 8% to £513 million driven by the costs of mandatory change programmes such as the Single Euro Payment Area, £18 million, an investment of £10 million in programmes to support customers in financial difficulty and an accelerated depreciation charge of £12 million.

Impairment losses, excluding the impact of RCR, were £482 million, 35% lower. This was predominantly due to a sharp reduction in losses on the mortgage portfolio which reduced by £411 million or 64% due to a decline in arrears levels driven by an improved collections performance and the development of programmes to assist customers in financial difficulty, coupled with stabilising residential property prices.

The loan:deposit ratio reduced from 130% to 120% during 2013 reflecting continued customer deleveraging and low levels of demand for new lending. Retail and SME deposit balances increased by 2% during 2013, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.

## Financial review

### US Retail & Commercial

|                                           | 2013<br>US\$m | 2012<br>US\$m | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|---------------|---------------|------------|------------|
| Net interest income                       | 2,960         | 3,071         | 1,891      | 1,938      |
| Net fees and commissions                  | 1,190         | 1,253         | 761        | 791        |
| Other non-interest income                 | 489           | 584           | 312        | 368        |
| Non-interest income                       | 1,679         | 1,837         | 1,073      | 1,159      |
| Total income                              | 4,639         | 4,908         | 2,964      | 3,097      |
| Direct expenses                           |               |               |            |            |
| - staff costs                             | (1,667)       | (1,605)       | (1,065)    | (1,013)    |
| - other                                   | (1,521)       | (1,609)       | (972)      | (1,014)    |
| - litigation settlement                   | —             | (138)         | —          | (88)       |
| Indirect expenses                         | (81)          | (47)          | (51)       | (31)       |
|                                           | (3,269)       | (3,399)       | (2,088)    | (2,146)    |
| Operating profit before impairment losses | 1,370         | 1,509         | 876        | 951        |
| Impairment losses                         | (244)         | (145)         | (156)      | (91)       |
| Operating profit                          | 1,126         | 1,364         | 720        | 860        |
| Average exchange rate - US\$/£            |               |               | 1.565      | 1.585      |
|                                           | US\$bn        | US\$bn        | £bn        | £bn        |
| Balance sheet                             |               |               |            |            |
| Loans and advances to customers (gross)   |               |               |            |            |
| - residential mortgages                   | 9.6           | 9.4           | 5.8        | 5.8        |
| - home equity                             | 20.1          | 21.5          | 12.1       | 13.3       |
| - corporate and commercial                | 39.8          | 38.5          | 24.1       | 23.8       |
| - other consumer                          | 14.1          | 13.5          | 8.6        | 8.4        |
|                                           | 83.6          | 82.9          | 50.6       | 51.3       |
| Loan impairment provisions                | (0.4)         | (0.5)         | (0.3)      | (0.3)      |
| Net loans and advances to customer        | 83.2          | 82.4          | 50.3       | 51.0       |
| Customer deposits (excluding repos)       | 91.1          | 95.6          | 55.1       | 59.2       |
| Spot exchange rate - US\$/£               |               |               | 1.654      | 1.616      |

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## Financial review

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### US Retail & Commercial *continued*

On 1 November 2013, RBS announced plans to accelerate its previously announced partial initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. RBS intends to fully divest its position in RBSCFG by the end of 2016, leaving it as a standalone regional bank, owned by public shareholders.

RBSCFG has commenced a number of actions in 2013 aimed at improving financial performance. RBSCFG continued to drive profitable growth in its core business by focusing on the customer and delivering a differentiated experience. In addition, RBSCFG has launched a series of initiatives aimed at narrowing the performance gap with competitors, including selectively expanding lending areas where RBSCFG has proven capabilities (such as Mid-Corporate, Specialty Verticals) and selective expansion of risk appetite (moving from super-prime to prime in certain products).

RBSCFG has also launched transformational initiatives in 2013 including:

- A special initiative called Project 'TOP', 'Tapping Our Potential'. The project intends to improve the overall effectiveness and efficiency of the franchise by utilising ideas generated by our colleagues.
- On 7 January 2014, RBSCFG announced the sale of its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, the lead bank of U.S. Bancorp. RBSCFG will maintain a presence in Chicago through its commercial business lines and several national consumer business lines not included in the sale<sup>(1)</sup>. The sale, expected to close in mid-2014 (subject to regulatory approval), includes 94 Charter One branches in the Chicago area, \$5.3 billion in local deposits and \$1.1 billion in locally originated loans for a deposit premium of approximately \$315 million, or 6%. The proceeds will be reinvested in the remaining franchise, where we have stronger market positions and better long-term growth prospects.

Moreover, RBSCFG continued to grow its core franchise by consistently delivering a differentiated customer experience and leveraging its strong market presence (top 5 deposit market share in 8 of its top 10 Metropolitan Statistical Areas).

In 2013, Consumer Banking continued to improve customer convenience, address the shift in customer preference, and expand its distribution presence. Consumer Banking installed more than 900 intelligent deposit machines (enhanced ATMs), improved the web account opening process, simplified online banking log-in, and released a new mobile application optimised for the iPad. Consumer Banking also implemented a new branch image capture system throughout the network that automates teller processing and offers secure paperless transactions, debit card identification and clear receipts that provide on-the-spot balance availability.

#### Notes:

- (1) RBSCFG will continue to operate several businesses in the Chicago market, including the consumer businesses lines of mortgage lending, Education Finance and Auto Finance. RBS Citizens, the bank's commercial banking division, will continue a diverse range of commercial banking operations in Chicago including Asset-Based Lending, Asset Finance, Equipment Leasing, Commercial Real Estate, Treasury Solutions, Capital Markets, Sponsor Finance, Franchise Finance and the majority of its corporate banking business.
- (2) Source: SNL Financial. Based on most recent regulatory data as of Q3 2013. Market includes all US banks required to file regulatory reports.

In recognition of the customer experience it offers, Money magazine named Citizens Bank one of the "Best Banks in America" in 2013. In addition to a "robust presence" defined by its many branches and ATMs, Money recognised RBSCFG's extended branch hours that include seven-day-a-week supermarket branches. Money also noted that RBSCFG's convenience options also extend to its mobile banking apps for Android and iPhone, which are generating positive customer feedback in the industry. An August report issued by Xtreme Labs noted that "Citizens Bank is the only bank with the highest rated apps on both Android (4.5 stars) and iOS (4.5 stars) platforms".

The Small Business Banking and Commercial Enterprise Banking divisions were integrated into one consolidated Business Banking division within Consumer Banking, targeting companies with up to \$25 million in annual sales. The consolidation will enhance the customer experience, transform sales and service, and align products and processes.

Commercial Banking remained focused on growing and deepening relationships by providing thought leadership and improved product capabilities to clients. Commercial and Industry loan growth was 8.5% compared with the same time period a year ago, which was 1.3% higher than the market<sup>(2)</sup>. The strong results are partially due to the launch of several growth initiatives, which includes expanding our MidCorporate business nationally, as well as growing our Franchise Finance, Lender Finance and other key industry verticals.

Corporate Finance & Capital Markets continued to take market share from both regional competitors and large money centre banks. Commercial Banking moved up in the Overall Middle Market Bookrunner league table from an unranked position in 2009 to #6 by origination volume and #8 by number of transactions in Q4 2013.

Furthermore, the strategic alliance with Oppenheimer allowed Commercial bankers to deliver M&A ideas and solutions that are helping us provide comprehensive solutions to our clients. This alliance won the Barlow Research Associates' Monarch Innovation Award for "Most Innovative Product". The award highlights RBSCFG's commitment to making it easier for middle market companies to develop financial strategies that encompass both commercial banking and investment banking products and services.

As a result of our ongoing focus on providing thought leadership to our clients, our most recent client survey (Q3 2013) showed significant improvement in Middle Market customer satisfaction metrics over the same period a year ago. Net Promoter score increased from 36 to 50, which is well above the peer average of 42. "Proactively Provides Advice and Solutions" score was up from 62% to 85% and lead relationships as a percent of total relationships improved from 51% to 58%. Both metrics are strong indicators of our Commercial bankers' thought leadership capabilities.

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## Financial review

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### US Retail & Commercial continued

#### 2013 compared with 2012

Operating profit of \$1,126 million was down \$238 million, or 17%. The operating environment and market conditions remained challenging, with intense competition for loans. An extended period of low short-term rates limited net interest margin expansion and the rise in long-term rates dramatically slowed mortgage refinance volumes.

Net interest income was down 4% at \$2,960 million due to a smaller investment portfolio, consumer loan run-off and the effect of prevailing economic conditions on asset yields partially offset by the benefit of interest rate swaps, commercial loan growth and favourable funding costs.

Average customer deposits were flat, with planned run-off of high priced time deposits and lower wholesale deposits offset by growth achieved in checking and money market balances. Consumer checking balances grew by 3% while small business checking balances grew by 7% over the year.

Average loans and advances were flat, with commercial loan growth of 5% despite competition for lending opportunities offset by run-off of long-term fixed-rate consumer products.

Excluding the \$75 million gross gain on the sale of Visa B shares in 2012, non-interest income was down \$83 million, or 5% at \$1,679 million, reflecting lower mortgage banking fees as refinancing volumes have slowed, and lower deposit fees. This was partially offset by higher securities gains and commercial banking fee income.

Excluding the \$138 million litigation settlement in 2012 relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010 and the \$13 million litigation reserve associated with the sale of Visa B shares, total expenses of \$3,269 million were broadly in line with prior year. This largely reflects a mortgage servicing rights impairment recapture driven by the increase in long-term rates offset by the cost of regulatory compliance and new technology investments and a one-off \$33 million pension gain in 2012.

Impairment losses increased by \$99 million to \$244 million for the year and represented 0.3% of loans and advances to customers.

## Financial review

| Markets                                   | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|------------|------------|
| Net interest expense                      | (39)       | (273)      |
| Net fees and commissions                  | 45         | 58         |
| Income from trading activities            | 2,978      | 3,938      |
| Other operating income                    | 49         | 172        |
| Non-interest income                       | 3,072      | 4,168      |
| Total income                              | 3,033      | 3,895      |
| Direct expenses                           |            |            |
| - staff costs                             | (1,153)    | (1,284)    |
| - other                                   | (707)      | (670)      |
| Indirect expenses                         | (461)      | (440)      |
|                                           | (2,321)    | (2,394)    |
| Operating profit before impairment losses | 712        | 1,501      |
| Impairment (losses)/recoveries (1)        | (26)       | 4          |
| Operating profit                          | 686        | 1,505      |

|                                                     | £bn   | £bn   |
|-----------------------------------------------------|-------|-------|
| Balance sheet                                       |       |       |
| Loans and advances to customers                     | 25.1  | 29.3  |
| Loan impairment provisions                          | (0.2) | (0.2) |
| Net loans and advances to customers                 | 24.9  | 29.1  |
| Loans and advances to banks                         | 24.3  | 36.3  |
| Reverse repos                                       | 76.1  | 103.4 |
| Securities                                          | 67.1  | 86.4  |
| Cash and eligible bills                             | 19.1  | 26.8  |
| Other                                               | 8.0   | 10.4  |
| Total assets (excluding derivatives mark-to-market) | 219.5 | 292.4 |
| Customer deposits (excluding repos)                 | 24.6  | 30.1  |

Note:

(1) Includes £18 million pertaining to the creation of RCR and related strategy.

In 2013, Markets launched and executed a strategic repositioning of the business, aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths in fixed income products. The division met or exceeded all internal targets for reducing controllable costs, risk weighted assets and balance sheet, while meeting revenue and operating profit expectations. Controls were enhanced, trading was integrated into four financial hubs, the front-to-back operating model was simplified and an agreement was reached for the sale of the Investor Products and Equity Derivatives business. Market share in the four core product areas (Rates, Currencies, Asset Backed Products and Credit) remained broadly stable with high profile client transactions executed across the globe. As a result of the strategic repositioning, Markets ended 2013 better positioned for the changing regulatory and external environment.

### 2013 compared with 2012

Operating profit fell by £819 million with income falling by 22%.

Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment. Client activity was limited by the uncertainty that surrounded the much anticipated tapering of the Federal Reserve's programme of quantitative easing. This contrasted with 2012 when markets were boosted by the European Central Bank's Long Term Refinancing Operation.

Costs fell by 3%, reflecting a reduction in headcount and tightly controlled discretionary expenses, although this was offset by a higher level of legal costs, primarily related to legacy issues in the US Asset Backed Products business.

The increase in impairments was driven by a small number of single name exposure in 2013.

Reducing risk and refocusing the division on core fixed income and currencies products drove a substantial reduction in the balance sheet. Total assets were £73 billion lower than 31 December 2012.

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## ***Financial review***

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### **Central items**

|                             | 2013<br>£m | 2012<br>£m |
|-----------------------------|------------|------------|
| Central items not allocated | (1,461)    | (1,613)    |

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

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

### **2013 compared with 2012**

Central items not allocated represented a charge of £1,461 million in 2013 compared with a charge of £1,613 million in 2012, a reduction of £152 million.



## Financial review

### Non-Core

|                                           | 2013<br>£m | 2012<br>£m |
|-------------------------------------------|------------|------------|
| Net interest income                       | 501        | 865        |
| Net fees and commissions                  | 66         | 111        |
| Loss from trading activities              | (20)       | (565)      |
| Other operating income                    | 162        | 1,324      |
| Non-interest income                       | 208        | 870        |
| Total income                              | 709        | 1,735      |
| Direct expenses                           |            |            |
| - staff                                   | (186)      | (250)      |
| - other                                   | (176)      | (370)      |
| Indirect expenses                         | (95)       | (97)       |
|                                           | (457)      | (717)      |
| Operating profit before impairment losses | 252        | 1,018      |
| Impairment losses (1)                     | (4,654)    | (2,209)    |
| Operating loss                            | (4,402)    | (1,191)    |

|                                         | £bn    | £bn    |
|-----------------------------------------|--------|--------|
| Balance sheet                           |        |        |
| Total assets (excluding derivatives)    | 26.1   | 52.7   |
| Total assets (including derivatives)    | 29.2   | 58.5   |
| Loans and advances to customers (gross) | 34.6   | 51.8   |
| Loan impairment provisions              | (13.7) | (10.8) |
| Net loans and advances to customers     | 20.9   | 41.0   |
| Customer deposits                       | 1.4    | 1.6    |

Note:

(1) Includes £3,116 million pertaining to the creation of RCR and related strategy.

### 2013 compared with 2012

Operating loss of £4,402 million was £3,211 million higher than 2012, principally due to a £2,445 million increase in impairments. This was predominantly due to £3,116 million of 2013 impairments related to the creation of RCR, most significantly with £2,299 million in Ulster Bank and £740 million in International Banking, driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans, which has led to increased impairment losses on the non-performing assets.

Operating profit before impairment losses was £766 million lower with a reduction in net interest income of £364 million, £207 million additional disposal losses and £104 million further fair value writedowns offset by £545 million lower losses from trading activities.

The reduction in net interest income of £364 million was driven by a 31% fall in interest earning assets driven by run-off and disposals.

## Financial review

### Consolidated balance sheet at 31 December 2013

|                                                   | 2013<br>£m       | 2012<br>£m       |
|---------------------------------------------------|------------------|------------------|
| <b>Assets</b>                                     |                  |                  |
| Cash and balances at central banks                | 79,993           | 74,524           |
| Net loans and advances to banks                   | 40,044           | 47,623           |
| Reverse repurchase agreements and stock borrowing | 26,439           | 34,444           |
| Loans and advances to banks                       | 66,483           | 82,067           |
| Net loans and advances to customers               | 389,203          | 424,794          |
| Reverse repurchase agreements and stock borrowing | 49,897           | 70,043           |
| Loans and advances to customers                   | 439,100          | 494,837          |
| Debt securities                                   | 100,696          | 136,585          |
| Equity shares                                     | 8,278            | 13,872           |
| Settlement balances                               | 5,634            | 5,717            |
| Derivatives                                       | 289,403          | 445,101          |
| Intangible assets                                 | 12,352           | 12,403           |
| Property, plant and equipment                     | 7,866            | 9,694            |
| Deferred tax                                      | 3,435            | 3,066            |
| Prepayments, accrued income and other assets      | 5,904            | 6,104            |
| Assets of disposal groups                         | 790              | 304              |
| <b>Total assets</b>                               | <b>1,019,934</b> | <b>1,284,274</b> |
| <b>Liabilities</b>                                |                  |                  |
| Bank deposits                                     | 36,551           | 57,937           |
| Repurchase agreements and stock lending           | 28,612           | 44,323           |
| Deposits by banks                                 | 65,163           | 102,260          |
| Customer deposits                                 | 415,847          | 431,200          |
| Repurchase agreements and stock lending           | 56,457           | 87,997           |
| Customer accounts                                 | 472,304          | 519,197          |
| Debt securities in issue                          | 59,746           | 83,278           |
| Settlement balances                               | 5,245            | 5,832            |
| Short positions                                   | 28,004           | 27,541           |
| Derivatives                                       | 286,133          | 436,085          |
| Accruals, deferred income and other liabilities   | 14,753           | 12,027           |
| Retirement benefit liabilities                    | 3,188            | 3,854            |
| Deferred tax                                      | 189              | 789              |
| Subordinated liabilities                          | 33,134           | 33,851           |
| Liabilities of disposal groups                    | 3,210            | 135              |
| <b>Total liabilities</b>                          | <b>971,069</b>   | <b>1,224,849</b> |
| Non-controlling interests                         | 79               | 137              |
| Owners' equity                                    | 48,786           | 59,288           |
| <b>Total equity</b>                               | <b>48,865</b>    | <b>59,425</b>    |
| <b>Total liabilities and equity</b>               | <b>1,019,934</b> | <b>1,284,274</b> |

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## Financial review

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### Commentary on consolidated balance sheet

#### 2013 compared with 2012

Total assets of £1,019.9 billion at 31 December 2013 were down £264.3 billion, 21%, compared with 31 December 2012. This was driven by the downsizing of the Markets business, primarily reflected in decreases in loans to banks and customers, debt securities and derivatives balances, and a further decrease in loans and advances to banks and customers due to Non-Core disposals and run off.

Loans and advances to banks decreased by £15.6 billion, 19%, to £66.5 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £8.0 billion, 23%, to £26.4 billion, bank placings declined £7.6 billion, 16%, to £40.1 billion.

Loans and advances to customers declined £55.7 billion, 11%, to £439.1 billion. Within this, reverse repurchase agreements were down £20.1 billion, 29%, to £49.9 billion. Customer lending decreased by £35.6 billion, 8%, to £389.2 billion, or £31.3 billion to £414.2 billion before impairments. This reflected significant reductions in Non-Core of £17.2 billion as a result of disposals and run-off, along with declines in other divisions, principally in International Banking, £4.9 billion, UK Corporate, £4.5 billion and Markets, £4.2 billion.

Debt securities were down £35.9 billion, 26%, to £100.7 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds. Equity shares decreased by £5.6 billion, 40%, to £8.3 billion due to the targeted run-down of Markets' equities business.

Movements in the value of derivative assets, down £155.7 billion, 35%, to £289.4 billion, and liabilities, down £150.0 billion, 34% to £286.1 billion, primarily reflects upward shifts in major yield curves which resulted in significant mark-to-market decreases on interest rate contracts. Property, plant and equipment decreased by £1.8 billion, 19%, to £7.9 billion driven largely by the disposal of Non-Core assets.

The increase in assets and liabilities of disposal groups, up £0.5 billion to £0.8 billion, and £3.1 billion to £3.2 billion respectively, primarily reflects the transfer to disposal groups of selected Chicago-area operations of RBS Citizens.

Deposits by banks decreased £37.1 billion, 36%, to £65.2 billion, with decreases in inter-bank deposits, down £21.4 billion, 37%, to £36.6 billion and repurchase agreements and stock lending ('repos'), down £15.7 billion, 35%, to £28.6 billion, as a result of the Group's lower funding requirements and reduced derivative cash collateral.

Customer accounts decreased £46.9 billion, 9%, to £472.3 billion. Within this, repos decreased £31.5 billion, 36%, to £56.5 billion. Excluding repos, customer deposits were down £15.4 billion, 4%, at £415.8 billion, primarily reflecting decreases in US Retail & Commercial, £7.3 billion, which included the impact of £3.2 billion of customer deposits being transferred to liabilities of disposal groups at 31 December 2013, Markets, £5.5 billion, International Banking, £2.9 billion, UK Corporate, £2.4 billion and Wealth, £1.7 billion. These decreases were partially offset by increases in UK Retail, £7.3 billion.

Debt securities in issue decreased £23.5 billion, 28%, to £59.7 billion due to lower funding requirements as a result of the reduction in the overall size of the balance sheet, with most of the reduction in medium term notes in issue.

Retirement benefit liabilities decreased by £0.7 billion, 17%, to £3.2 billion with net actuarial gains of £0.4 billion arising from improved asset returns and higher discount rates partly offset by an increase in the assumed inflation rate. Additional employer contributions of £0.4 billion to the Group's Main Scheme also reduced retirement benefit liabilities.

Subordinated liabilities decreased by £0.7 billion, 2% to £33.1 billion, primarily as a result of the net decrease in dated loan capital with redemptions of £1.4 billion and the effects of exchange and other movements of £1.2 billion being partially offset by issuances of £1.9 billion.

Owner's equity decreased by £10.5 billion, 18%, to £48.8 billion, driven by the £7.3 billion attributable loss for the period together with movements in cash flow hedging reserves, £1.9 billion, available-for-sale reserves, £1.4 billion, foreign exchange reserves, £0.2 billion and other reserve movements, £0.1 billion. Partially offsetting these reductions were share issuances of £0.2 billion and the recognition of actuarial gains in respect of the Group's defined benefit pension schemes, net of tax, £0.2 billion.

## Financial review

### Cash flow

|                                                               | 2013<br>£m | 2012<br>£m |
|---------------------------------------------------------------|------------|------------|
| Net cash flows from operating activities                      | (20,965)   | (30,436)   |
| Net cash flows from investing activities                      | 16,502     | 26,652     |
| Net cash flows from financing activities                      | (1,084)    | 4,396      |
| Effects of exchange rate changes on cash and cash equivalents | 402        | (3,347)    |
| Net decrease in cash and cash equivalents                     | (5,145)    | (2,735)    |

#### 2013

The major factors contributing to the net cash outflow from operating activities of £20,965 million were the decrease of £18,983 million in operating assets and liabilities, the net operating loss before tax of £6,761 million, loans and advances written-off net of recoveries of £3,975 million and other provisions utilised of £2,046 million. These were partially offset by provisions for impairment losses of £8,449 million and other provisions charged net of releases of £4,407 million.

Net cash inflows from investing activities of £16,502 million related to the net inflows from sales of securities of £12,074 million, the sale of property, plant and equipment of £888 million and net investment of business interests and intangible assets of £4,237 million offset by net cash outflows from the purchase of property, plant and equipment of £697 million.

Net cash outflows from financing activities of £1,084 million relate primarily to the repayment of subordinated liabilities of £1,868 million and interest paid on subordinated liabilities of £1,395 million partly offset by the issue of subordinated liabilities of £2,285 million.

#### 2012

The major factors contributing to the net cash outflow from operating activities of £30,436 million were the decrease of £36,173 million in operating assets and liabilities, loans and advances written-off net of recoveries of £3,555 million and operating loss before tax of £3,524 million, partially offset by depreciation and amortisation £1,614 million, the elimination of foreign exchange differences of £6,111 million and provisions for impairment losses of £5,214 million.

Net cash inflows from investing activities of £26,652 million related to net inflows from sales and maturities of securities of £17,664 million, net investment in business interests and intangible assets of £8,245 million and the sale of property, plant and equipment of £2,099 million, partially offset by the purchase of property, plant and equipment of £1,356 million. Net investments in business interests and intangible assets is primarily attributable to £8,933 million of cash in relation to businesses transferred from RBS N.V.

Net cash inflows from financing activities of £4,396 million primarily arose from the issue of subordinated liabilities of £2,968 million and a capital contribution of £2,870 million, offset in part by repayment of subordinated liabilities of £264 million and interest paid on subordinated liabilities of £1,114 million.

**Financial review** *Risk and balance sheet management*

| Risk and balance sheet management |                            |
|-----------------------------------|----------------------------|
| 29                                | Risk governance            |
| 36                                | Risk appetite              |
| 46                                | Capital management         |
| 51                                | Liquidity and funding risk |
| 62                                | Credit risk                |
| 96                                | Balance sheet analysis     |
| 157                               | Market risk                |
| 173                               | Country risk               |
| 186                               | Other risks                |

|                 |                                 |
|-----------------|---------------------------------|
| Risk governance |                                 |
| 30              | Governance structure            |
| 30              | Risk management                 |
| 31              | Conduct and Regulatory Affairs  |
| 31              | Business model                  |
| 32              | Risk events and lessons learned |
| 33              | Top and emerging risk scenarios |
| 35              | Stress testing                  |

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## Financial review *Risk and balance sheet management*

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### Presentation of information

Except as otherwise indicated by an asterisk (\*), information in the Risk and balance sheet management section (pages 28 to 195) is within the scope of the Independent auditor's report.

Risk and balance sheet management are conducted on an overall basis within the RBS Group such that common policies, procedures, frameworks and models apply across the RBS Group. Therefore, for the most part, discussions on these on these aspects reflect those in the RBS Group as relevant for the businesses and operations in the Group.

### Risk governance\*

#### Governance structure

The RBS Group is committed to achieving the highest standards of corporate governance in every aspect of the business, including risk management.

A key aspect of the RBS Group Board's responsibility as the main decision-making body at RBS Group level is the setting of RBS Group risk appetite to ensure that the levels of risk the RBS Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood.

The day-to-day management of risk in the RBS Group is carried out through two independent risk management functions: RBS Risk Management and RBS Group Conduct and Regulatory Affairs, which manage risk through independent oversight and challenge of both the customer-facing businesses and the support functions. These risk management functions provide an overarching risk control framework linked to the risk appetite of the RBS Group. For further detail on risk appetite, refer to page 36.

To enable the RBS Group Board to carry out its objectives, it delegates authority to various committees as required and appropriate. A number of key committees specifically consider risk across the RBS Group:

*Group Board* - Sets and owns the RBS Group's risk appetite, which is cascaded across its divisions, functions and material legal entities. The RBS Group Board also sets the RBS Group's strategic direction and carries out regular assessments to ensure that strategic plans are consistent with risk appetite.

*Board Risk Committee* - Provides oversight and advice on current and potential risk exposures, risk strategy and tolerance. The Committee also promotes a risk awareness culture within the RBS Group.

*Group Executive Committee* - Operates under delegated authority from the RBS Group Board and considers emerging issues material to both the RBS Group's strategy and risk exposures. The RBS Group Executive Committee also oversees control frameworks.

*Executive Risk Forum* - Provides executive input to the RBS Group Board and the RBS Group Executive Committee on risk management issues such as risk appetite, risk policies and risk management strategies. It has full authority to act on all material and/or enterprise-wide risk and control matters across the RBS Group and implements Group Board and Group Executive Committee risk management decisions.

*Group Audit Committee* - Reviews accounting policies, financial reporting and regulatory compliance practices of the RBS Group, as well as its systems and standards of internal controls. It monitors the RBS Group's processes for internal audit and external audit and relationships with regulatory authorities. It operates under delegated authority from the RBS Group Board.

*Group Risk Committee* - Oversees and acts on material and enterprise-wide risk and control matters across the RBS Group. It reviews and challenges risks and limits across the functional areas. It reviews risks and issues on both a thematic and specific basis, focusing on forward-looking, emerging risks. It considers the overall risk profile across the RBS Group and identifies any key issues for escalation to the Executive Risk Forum. It operates under delegated authority from the Executive Risk Forum.

In addition, functional risk committees ensure that effective risk control frameworks are in place and that limits are consistent with the RBS Group's risk appetite. Divisional executive committees develop, own and manage divisional risk appetites, ensuring that these are consistent with the RBS Group's targets.

### Risk management

The RBS Group Chief Risk Officer leads RBS Risk Management through the strategic setting and execution of its responsibilities. The RBS Group Chief Risk Officer reports directly to the RBS Group Chief Executive and the Board Risk Committee, with a right of access to the Chairman of the Board Risk Committee.

RBS Risk Management is designed to align as closely as possible with the customer-facing businesses and support functions while maintaining an appropriate level of independence. This underpins the RBS Group's approach to risk management and is reinforced through the RBS Group by reporting lines from divisions to RBS Risk Management and from RBS Risk Management to senior executives, Boards and Committees.

In RBS Risk Management, the following RBS Group risk functional heads report directly to the RBS Group Chief Risk Officer and are responsible for RBS Group-wide risk appetite and standards under their respective disciplines:

- RBS Group Head of Operational Risk;
- RBS Group Chief Credit Officer;
- Head of Enterprise Risk Management;
- Head of Global Country Risk; and
- Chief Operating Officer, RBS Risk Management.

Risk management in divisions focuses on all material risks including credit, market, operational, regulatory, country and business risk (refer to pages 41 to 45 for further detail of these risks). Liquidity risk and the day-to-day management of liquidity and funding of the RBS Group's assets is RBS Group Treasury's responsibility (refer to page 40). Oversight of risk in divisions is the responsibility of the relevant divisional Chief Risk Officer (CRO), with input from the relevant RBS Group risk function heads.

\*unaudited

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## Financial review *Risk and balance sheet management*

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This involves ensuring:

- All activities undertaken by the individual divisions are consistent with the RBS Group's risk appetite targets;
- RBS Group policies and resulting operating frameworks, including delegated authorities and limits, are complied with through effective monitoring and exception reporting; and
- Operation of RBS Group-wide risk processes such as the RBS Group Policy Framework and the New Product Risk Assessment Process are effective.

Divisional CROs report directly to the RBS Group Chief Risk Officer.

The RBS Group Chief Risk Officer has direct involvement in the selection, appointment or removal of divisional CROs and Group risk function heads and also has responsibility for their ongoing performance assessment and management.

Divisions mirror the RBS Group risk management structure: divisional executive committees are responsible for setting and managing their exposures in line with their risk appetite and within RBS Group constraints. The divisional risk committees oversee risk exposures arising from divisional business activities and focus on ensuring that the associated risks are adequately monitored and controlled. The divisional CROs provide independent oversight of this process, with support from the RBS Group Chief Risk Officer and RBS Group risk function heads as appropriate. Additional challenge and oversight is provided by RBS Group risk function heads on an ongoing basis and by divisional risk and audit committees on a periodic review basis. For a summary of the main risk types faced by the RBS Group and how it manages each of them, refer to pages 40 to 45.

### Conduct and Regulatory Affairs

Created in August 2013, by amalgamating RBS Group Compliance (previously part of RBS Risk Management) and RBS Regulatory Affairs (formerly part of RBS Legal), Group Conduct and Regulatory Affairs is led by the RBS Group Head of Conduct and Regulatory Affairs, who reports directly to the RBS Group Chief Executive and the Board Risk Committee, with right of access to the Chairman of the Board.

The following functional heads report directly to the RBS Group Head of Conduct and Regulatory Affairs, each of whom is responsible for the firm-wide risk appetite and standards of their respective disciplines: the Global Head of Compliance; the Global Head of Financial Crime; and the Director, RBS Regulatory Affairs.

A Chief Compliance Officer in each division (reporting to the Global Head of Compliance) provides advisory support to assist the divisions' management of conduct, regulatory affairs and financial crime.

### Three lines of defence

The three lines of defence is an industry-wide model for the management of risk, understood as a clear set of principles by which to implement a cohesive operating model across an organisation. The model's main purpose is to define accountabilities and responsibilities for managing risk across the organisation.

**1st line of defence** - Business units including all business areas and functions are accountable for owning and managing the risks which exist in their area within a defined risk appetite and framework.

**2nd line of defence** - Independent monitoring and control functions, as well as RBS Group Policy Standard owners, are accountable for owning and developing the risk and control frameworks and tools which the 1st line of defence uses to discharge its responsibilities. The 2nd line of defence must be appropriately independent from the business and accountable for overseeing and challenging the 1st line of defence on the effective management of its risks.

**3rd line of defence** - RBS Group Internal Audit provides independent assurance on the appropriateness of the design and operational effectiveness of risk management and internal control processes that mitigate the RBS Group's key risks.

### Business model

The Group is a bank serving approximately 24 million retail and corporate customers worldwide. UK Retail offers individuals a wide range of traditional retail banking and insurance products, including residential mortgages and credit cards, while UK Corporate provides both small businesses and large corporations with an extensive range of loan products and transactional services. Most of the customers of both divisions are located in the UK. Wealth provides both banking and investment services to high-net-worth individuals in the UK and overseas, while International Banking offers loan products and transactional services to corporations and financial institutions across a wide range of countries. Markets provides corporations and financial institutions in both the UK and overseas with investment banking products and services, helping them to hedge exposures to interest rate and foreign exchange risk. Markets also helps customers structure securitisation transactions and issue debt.

In addition, Ulster Bank and Citizens Bank, offer loan and investment products, as well as transactional services, to individuals and corporations. The customers of Ulster Bank are in Ireland while those of Citizens Bank are in the US. The Group delivers its products through a diverse array of channels, including extensive branch networks, in-store branches and call centres in addition to online and mobile channels.

It is the aim of the Group to become a bank that customers, and all other stakeholders, can depend on. It intends to do so by focusing on its core retail and corporate customers in its main market of the UK. It plans to simplify its products and services as well as the processes it uses to deliver them, enhancing their appeal. Simplifying processes should also lower costs, enabling the bank to provide customers with better products and services at lower prices.

The Group's main sources of earnings are interest income from lending and deposits and fee income from transactional and other services. Given the low interest rate environment in both the UK and the US, its net interest margin, that is, the difference between the interest it earns from lending and the interest it pays on deposits, has been under pressure. In order to offset this pressure, the Group is working to reduce costs and increase non-interest income.



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## Financial review *Risk and balance sheet management*

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### **Risk governance\*** continued

#### **Business model** continued

Over the last few years, the Group has either exited or sold a number of businesses in order to align its cost structure with its smaller scope and scale. In addition, it is reducing costs through rationalisation, integration and simplification. For example, UK Retail is rationalising its service delivery channels and simplifying the operations that support them, using the resulting cost savings to invest in new technology and providing additional channels for customers such as mobile banking. A number of other divisions are taking similar steps.

The Group's activities expose it to a number of risks. The Group is pursuing a strategy of reducing the risks it takes while focusing on the delivery of products and services to a domestic customer base, giving rise to strategic risk. The delivery of all of its products and services exposes the Group to conduct risk, which has recently materialised in the form of fines and reputational damage, resulting from a failure to treat customers in line with their and other stakeholders' expectations.

The Group also faces a range of other risks. As measured by risk-weighted assets (RWAs), the most significant of these is credit risk, which consists of counterparty and non-counterparty credit risk. Credit risk arises from its lending activities in all divisions. Counterparty credit risk arises from its security financing and derivative trading activities. This is concentrated in Markets.

The second most significant source of risk is market risk, which arises from the Group's trading activities (traded market risk) and from the impact of changes in market prices on the value of its other financial assets and liabilities (non-traded market risk). Traded market risk is concentrated in Markets while non-traded market risk is distributed across the Group and with the exception of US Retail & Commercial and Markets, these divisions transfer this risk to Group Treasury for management.

Operational risk, which arises from all of the Group's business activities, is the third most significant source of risk as measured by RWAs. Its importance is increasing as a result of changes driven by regulation as well as the Group's strategy.

The activities of several divisions, particularly Markets and International Banking, but also Ulster Bank and US Retail & Commercial, expose the Group to country risk.

Finally, through the activities of all its divisions, the Group is exposed to a range of other risks, including pension, business, regulatory and reputational.

### **Risk events and lessons learned**

#### **LIBOR related settlements**

The RBS Group reached settlements with the Financial Services Authority (FSA) in the United Kingdom, the United States Commodity Futures Trading Commission (CFTC) and the United States Department of Justice (DOJ) on 8 February 2013 in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). The RBS Group agreed to pay penalties of £87.5 million, \$325 million and \$150 million to the FSA, CFTC and DOJ respectively. As part of the settlement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement on one count of wire fraud relating to Swiss Franc LIBOR, and one count for an anti-trust violation relating to Yen LIBOR. RBS Securities Japan Limited also agreed to enter a plea of guilty to one count of wire fraud relating to Yen LIBOR.

Industry-wide investigations were made into the setting of certain benchmark rates across a range of currencies. Regulators found wrongdoing on the part of 21 RBS employees, predominantly in the setting of the bank's Yen and Swiss Franc LIBOR submissions.

Both before and after these findings were issued, management took action to strengthen significantly the systems and controls governing its LIBOR submissions: the RBS Group created an independent and ring-fenced rate-setting team; all relevant staff were obliged to undertake a comprehensive training programme; and new preventative and detective controls put in place, including monitoring and statistical checking of submissions by independent personnel in the RBS Group. A rate setting review board was also created to oversee the submission process.

For more information on LIBOR related settlements, refer to page 309.

#### **Payment Protection Insurance**

Since the judicial review decision in 2011, the RBS Group has worked closely with both the Financial Conduct Authority and the Financial Ombudsman Service. It has invested considerable resources in ensuring that all Payment Protection Insurance (PPI) complaints are handled in a fair manner in line with regulatory requirements. The RBS Group stopped selling PPI in 2010 and has since then made a number of changes to ensure fair customer outcomes and to ensure that the appropriate lessons are learned from PPI. These include substantially simplifying our retail product offering and sales processes (including, but not limited to, protection products), enhancing training for, and controls in relation to, customer advisers and improving management information on products sales. Our product design and approval processes are now also radically different from the time when PPI products were available to customers.

UK Retail and the wider RBS Group are engaged in a wide-ranging conduct risk programme designed to ensure the focus of our culture is always on the customer and delivering good customer outcomes. While this is a long-term project, the RBS Group is confident that it has already resulted in material changes to the way it conducts business.

For more information on PPI refer to pages 311 and 312. For information on other litigation, investigations and reviews, refer to pages 307 to 315.

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## Financial review *Risk and balance sheet management*

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### Top and emerging risk scenarios

As part of its risk management process, the RBS Group identifies and monitors its top and emerging risk scenarios. These are events that, should they materialise, would lead to a significant unexpected negative outcome, thereby causing the Group as a whole, or a particular division, to fail to meet one or more strategic objectives. In assessing the potential impact of risk materialisation, the Group takes into account both financial and reputational considerations.

Management is concerned with a range of risk scenarios. However, a small number attracted particular attention from senior management during the past year. These were grouped into four broad categories:

- Macroeconomic risks;
- Conduct, regulatory and legal risks;
- Risks related to the RBS Group's operations; and
- Political risk.

Further information on these and other risks facing the Group is detailed in Risk factors on pages 331 to 346.

The Group's top and emerging risks are as follows:

#### Macroeconomic risks

(i) Increased impairments arising from defaults in sectors to which the RBS Group has concentrated exposures, particularly commercial real estate and shipping

The Group has material exposure to borrowers in a number of sectors, particularly shipping. This sector has experienced falling revenues and declining asset values. If global economic growth remains subdued, losses in these sectors may increase unexpectedly. Any such losses may be exacerbated by issues related to controls.

#### Impact on the Group

If borrowers default, the value of the Group's collateral may prove inadequate to repay the associated debt, leading to increased impairments. UK Corporate is likely to be most affected.

#### Mitigants

Optimisation of the Group's shipping and a significant proportion of commercial real estate portfolios is part of Capital Resolution Group strategy.

(ii) Increased impairments arising from a more severe than expected economic downturn

The Group's return to profitability depends on the economic recovery of its major markets. If their recovery is slower than expected, the RBS Group's return to profitability and private ownership may also be deferred. All divisions could be affected.

#### Impact on the Group

A slower than expected recovery would likely result in lower revenues and income, and higher impairments. It could also result in higher operational losses. If such a downturn were prolonged, capital might also be negatively affected.

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#### Mitigants

The Group develops business plans to take into account the possibility of slow economic growth and implemented strategies, such as cost reductions, to reduce its vulnerability.

(iii) An increase in the Group's obligations to support pension schemes

The Group has established various pension schemes for its employees as a result of which it has incurred certain obligations as sponsor of these schemes. If economic growth stagnates and interest rates remain low as a result, the value of pension scheme assets may not be adequate to fund the pension schemes' liabilities. All of the Group's businesses are exposed to this risk.

#### Impact on the Group

As asset values were lower and liabilities higher when valued most recently, the Group may be required to set aside additional capital in support of the schemes. The amount of additional capital required depends on the size of the shortfall when the assets are valued as well as the efficacy, and acceptability to the regulator, of management actions undertaken to address it.

In addition, the Group may be required to increase its cash contributions to the schemes. Similarly, the amount of additional cash contributions that may be required depends on the size of the shortfall when the assets are valued. If interest rates fall further, the value of the schemes' assets may decline while the value of their liabilities increases, leading to a need to increase cash contributions.

#### Mitigants

The trustee is responsible for the investment of the main scheme's assets, which are held separately from the assets of the Group.

#### Conduct, regulatory and legal risks

(i) Increased conduct costs and reputational damage arising from a failure to achieve fair customer outcomes.

In order to achieve its strategic objectives, the Group must put the customer at the heart of its business.

#### Impact on the Group

Failure to do so would cause the Group to fail to achieve its strategic objectives, which would affect earnings, liquidity, capital and shareholder confidence adversely. The risk of failure affects all divisions.

#### Mitigants

In order to address this risk, during the year the Group continued to embed good conduct at the heart of the business to ensure fair outcomes for customers.

(ii) Losses or reputational damage arising from litigation

Given its diverse operations, the Group is exposed to the risk of litigation. For example, during the course of 2013, it was subject to shareholder litigation, securities related litigation, various class actions claims, including those related to LIBOR and foreign exchange trading, and mass consumer claims such as those related to Payment Protection Insurance and interest rate hedging products. This risk affects all of the RBS Group's divisions.

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## Financial review *Risk and balance sheet management*

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### **Risk governance\*** continued

#### **Top and emerging risk scenarios** continued

##### **Impact on the Group**

As a result of litigation, the Group may incur fines, be ordered to pay damages or other compensation, suffer reputational damage, or face limitations on its ability to operate. For example, in the case of LIBOR, the RBS Group agreed to pay settlement penalties to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements.

##### **Mitigants**

The Group defends claims against it to the best of its ability and it co-operates fully with various governmental and regulatory authorities.

(iii) Increased costs arising from a failure to demonstrate compliance with existing regulatory requirements related to conduct, particularly with respect to mis-selling

The Group is subject to regulation governing the conduct of its business activities. For example, it must ensure that it sells its products and services only to informed customers. This affects all divisions.

##### **Impact on the Group**

If the Group sells products to uninformed customers, or fails to handle complaints well, it may be subject to fines, incur remediation costs or even be subject to criminal charges. It may also suffer significant damage to its reputation.

##### **Mitigants**

Although more work needs to be done to mitigate this risk, the Group has simplified some products and stopped offering others. Where appropriate, it has compensated purchasers of some products and services, such as payment protection insurance and certain interest rate hedging products. Future payments of such compensation would give rise to additional costs.

##### **Risks related to the Group's operations**

(i) Increased losses arising from cyber attacks

The Group has experienced cyber attacks, which are increasing in frequency and severity across the industry. This risk affects all divisions.

##### **Impact on the Group**

A successful cyber attack could lead to fraudulent activity or the loss of customer data. The Group could experience significant losses as a result of the need to reimburse customers, pay fines or both. Furthermore, a successful cyber attack could cause significant damage to the RBS Group's reputation.

##### **Mitigants**

The Group has participated in an industry-wide cyber attack simulation. It has also initiated a large scale programme to improve controls over user access. In addition, it has reviewed its websites and taken steps to rationalise them, put additional anti-virus protections in place and taken steps to educate staff on information protection.

(ii) Increased losses arising from the failure of information technology systems

The Group's information technology systems are vulnerable to failure. Because they are complex, recovering from failure is very challenging.

##### **Impact on the Group**

A failure of information technology systems could lead to the Group's inability to process transactions or provide services to its customers. Should a failure not be rectified promptly, the Group might lose customers, be subject to fines, incur remediation costs or face legal action. Its reputation might also suffer.

##### **Mitigants**

The Group has launched a major investment programme to improve resilience, which has already had an impact. The Group has also enhanced its back up systems and created a 'shadow bank' capable of providing basic services in the event of need. Finally, the Group is improving the documentation of critical business functions.

(iii) Increased costs arising from a failure to execute successfully major projects

The Group has a number of major projects underway, the successful conclusion of which is essential if it is to meet new regulatory and strategic requirements. These new requirements affect its organisational structure, its business strategies, its information technology systems, its operational processes and its product offerings. Given the number, scale and complexity of these projects, the Group may not complete them successfully, or at all. This affects all divisions.

##### **Impact on the Group**

If the Group does not complete these projects successfully, the interests of customers may be affected, necessitating customer redress. The RBS Group may also incur regulatory fines, lose market share and suffer damage to its reputation.

##### **Mitigants**

The Group is working to implement change in line with its project plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.

(iv) Increased costs due to an inability to recruit or retain suitable staff

The Group is undergoing significant organisational change, the result of a need to implement new business strategies and respond to a changing external environment. The pace of change, coupled with the associated uncertainty may cause experienced staff members to leave the Group and prospective staff members not to join. Although these risks concern all divisions, they particularly affect Markets and US Retail & Commercial.

##### **Impact on the Group**

If it cannot retain or attract the necessary staff members, the Group may be unable to implement its business strategies or meet regulatory requirements on time, or at all. It may also experience control failures. The RBS Group's reputation may suffer as a result.

##### **Mitigants**

The Group has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses. The RBS Group is also working to develop and implement an enhanced recruitment strategy.

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## Financial review *Risk and balance sheet management*

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### Political risks

The RBS Group and the Royal Bank, its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of the referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the RBS Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the RBS Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the European Union.

The occurrence of any of the impacts above could significantly impact the RBS Group's costs and would have a material adverse effect on the Group's business, financial condition, results of operations, and prospects.

### Stress testing

#### Governance

Stress testing is the evaluation of a bank's financial position under severe but plausible stress scenarios. Stress testing also refers to the broader framework under which these tests are developed, evaluated and used within the Group's decision-making process in the context of the wider economic environment.

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

The Executive Risk Forum (refer to Risk governance on page 30 for further information) is the main body overseeing the RBS Group's stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any RBS Group-wide stress test and ensuring that, where necessary, appropriate management actions are undertaken.

The Board Risk Committee receives reports detailing stress tests undertaken as part of the financial planning process. It reviews and challenges the stress scenarios and considers their impact on the RBS Group's financial position. These reports outline relevant management actions as well as the extent to which such actions mitigate the effects of the stress scenario on the RBS Group's capital adequacy.

The Board Risk Committee may also request additional stress tests as it deems necessary. Stress testing forms part of the RBS Group's risk and capital management framework and is a major component of the Basel III requirements. It highlights to senior management potential unexpected adverse outcomes related to a mixture of risks and provides an indication of how much capital might be required to absorb losses should adverse scenarios materialise.

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### Scenario selection

Stress test scenarios target both firm-wide vulnerabilities and negative global impacts. They consider a five year horizon and include stress projections for macroeconomic variables such as gross domestic product, unemployment rates, property prices, stock price indices, interest rates and inflation. The tests include a variety of scenarios, including some featuring an intensification of the eurozone's sovereign debt problems.

Under one of them, there is a severe recession in the UK in 2013/2014, a sharp rise in unemployment and a marked fall in equity prices. There are downgrades of UK sovereign debt by two notches, and corresponding downgrades for UK banks, including the RBS Group, leading to increased funding costs and lower levels of lending. As the economic environment deteriorates, there is market concern about losses in the banking sector.

Another test run in 2013 is a high inflation-no growth scenario. Inflationary pressures surge as a result of the growth in central bank balance sheets in recent years. Sovereign bond yields rise steeply as market sentiment sours, and there is a reduction in disposable income and corporate profits, leading to a global recession. Recovery begins only in late 2014. As the bank's risk profile improves as a result of deleveraging, it should be better able to withstand extreme stress scenarios.

### Methodologies

Stress testing is part of the financial planning process and is conducted and presented to senior management semi-annually. Once simply conducted principally to meet regulatory requirements, it is now an integral part of enterprise risk management and used to assess the impact of business decisions on the RBS Group's capital position.

As part of the financial planning and strategy cycle, stress tests are conducted by divisions and aggregated to produce firm-wide results. These stress tests are also used for monitoring divisional and RBS Group risk appetite.

Risk-type specific stress testing is also conducted. For example, within the market risk management framework, a comprehensive programme of stress tests covers a variety of historical and hypothetical scenarios. Reverse stress testing, explicitly identifying and assessing scenarios most likely to render the bank's business model unviable, is also conducted as required by the PRA. In order to cross the business model failure threshold, an instantaneous one year global shock of a similar scale as the 2008 financial crisis is required, but the impact of such a scenario is more likely to be felt over multiple years. Future revenues, and the gradual disposal of Non-Core assets, would partially offset losses, making failure much less likely.

### Portfolios subject to review

Portfolio specific stress tests assess the reaction of key-focus portfolios to systemic shocks and individual risk factors to identify potential vulnerabilities, including risks that have not yet matured or are not yet visible. They assess the potential for outsized losses and the impact of rebalancing portfolios.

### External stress tests

The RBS Group also takes part in a number of external stress tests. In 2014 the RBS Group will take part in the Bank of England's concurrent stress test of the UK banking system, as well as an industry-wide external stress test conducted by the European Banking Authority on the European Union banking system.

|               |                                         |
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## Financial review *Risk and balance sheet management*

### Risk appetite\*

Risk appetite is both a key business tool and an integral part of the RBS Group's enterprise-wide approach to risk management. It is aligned with the RBS Group's strategic objectives, aiming to strike an optimal balance between building a sustainable risk profile and creating long-term value for the RBS Group's customers, investors and wider stakeholders. The risk appetite framework seeks to ensure that each business can withstand significant deteriorations in economic and market conditions.

The RBS Group's risk appetite is set and owned by the RBS Group Board which identifies and establishes the level and types of risks the RBS Group is able and willing to take in order to meet its:

- Strategic objectives - the RBS Group's strategic plan is built on the core foundations of serving customers well, building a sustainable risk profile and creating long-term value for its shareholders; and
- Wider obligations to stakeholders - a bank that is safe and sound and puts serving customers at the heart of its thinking will also perform well for its owners, employees, regulators and communities.

Risk appetite is cascaded and embedded across the RBS Group. The risk appetite framework provides each business with a greater understanding of acceptable risk levels, aligning commercial strategies with the most effective use of financial resources, such as capital, funding and risk capacity. Risk appetite provides a solid platform that allows the RBS Group to focus on its key business strengths and competitive advantages over the long term.

The Board Risk Committee reviews the RBS Group's risk appetite framework and targets on an annual basis to ensure they remain aligned with strategic objectives, business performance, emerging risks and changes in the external environment.



### Strategic risk objectives

Risk management plays an integral role in the delivery of the RBS Group's strategic goal. The implementation of a stronger and more effective culture of risk management and control provides the platform necessary to address vulnerabilities, rebuild on core strengths and position the RBS Group on a sustainable and profitable path for future growth.

Financial strength and resilience are at the heart of the RBS Group's strategic plan. The RBS Group has defined this level of robustness as that which is capable of achieving and sustaining a standalone credit rating (i.e. without government support) that is in line with those of its strongest international peers.

Given this central aim, in 2009 the RBS Group Board set out four key strategic objectives, aligned with the RBS Group's strategic plan.

- *Maintain capital adequacy.* To ensure that the RBS Group has sufficient capital resources to meet regulatory requirements and to cover the potential for unexpected losses in its asset portfolio.
- *Deliver stable earnings growth.* To ensure that strategic growth is based around a longer-term risk versus reward consideration, with significantly lower volatility in underlying profitability than was seen during the financial crisis.
- *Ensure stable and efficient access to funding and liquidity.* To ensure that the RBS Group has sufficient funding to meet its obligations, taking account of the constraint that some forms of funding may not be available when they are most needed.
- *Maintain stakeholder confidence.* To ensure that stakeholders have confidence in the RBS Group's recovery plan, its ability to deliver its strategic objectives and the effectiveness of its business culture and operational controls

Each objective is essential in its own right, but also mutually supportive of the others. The strategic risk objectives are the bridge between the RBS Group-level business strategy and the frameworks, limits and tolerances that are used to set risk appetite and manage risk in the business divisions on a day-to-day basis.

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## Financial review *Risk and balance sheet management*

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### Risk appetite\* continued

#### Risk appetite measures

Risk appetite starts with the strategic goals and risk philosophy set by the RBS Group Board and is cascaded through key targets, limits and risk tolerances that influence decision making, from the enterprise-wide to the transactional level.

The risk appetite framework is based on four main pillars:

- Risk envelope metrics - The RBS Group has set sustainable business goals over a medium-term horizon, including a target for the capital ratio, leverage ratio, loan:deposit ratio, liquidity portfolio and use of wholesale funding. These are the broad boundaries within which the RBS Group operates. Non-Core division also acts as a primary driver for reducing risk and the size of the balance sheet.
- Quantitative risk appetite targets - Risk appetite is also aligned with potential risk exposures and vulnerabilities under severe but plausible stress conditions. Quantitative targets, to be met under stress conditions, are set around the RBS Group's strategic risk objectives for maintaining capital adequacy, delivering stable earnings growth and ensuring stable and efficient access to funding and liquidity.
- Qualitative risk appetite targets - The fourth strategic risk objective of maintaining stakeholder confidence covers qualitative aspects relating to the culture of risk management and controls and meeting stakeholder expectations. Risk appetite is based around identified expectations across a range of stakeholders (e.g. customers, employees, investors and the general public) and is closely aligned with key risk policies and controls (e.g. the RBS Group Policy Framework, conduct risk and reputational risk).
- Risk control frameworks and limits - Risk control frameworks set detailed tolerances and limits for material risk types (e.g. credit risk, market risk, conduct risk and operational risk) that are used to manage risk on a day-to-day basis. These limits support and are required to be consistent with the high-level risk appetite targets.

The framework is supported by a programme of communication, engagement and training rolled out across the RBS Group to embed a wide understanding of the purpose and value of an effective risk appetite.

Risk appetite supports value creation in a safe sustainable way. It is embedded within the annual planning and budgeting process. Business strategies are designed on the basis of key value drivers (e.g. customer franchises, income and profit generation, synergies) and whether they fit within agreed risk appetite boundaries. A range of different but complementary tools have been developed to measure whether strategic plans are consistent with risk appetite, to test broader 'what if' questions and to assess the impact of changes in key assumptions:

- Integrated stress testing - assesses how earnings, capital and funding positions change under an unfavourable, yet plausible, scenario. Stress scenarios can differ by theme, geographical location or severity.

- Economic capital - provides complementary insights, with a breadth of understanding of risk profile changes and 'tail risks' generated by stimulating millions of different scenarios.
- Sensitivity analysis - provides 'ready reckoners' around changes in key variables. It provides a high-level view on questions such as 'what if gross domestic product worsened by a further 1%', identifying certain tipping points where the RBS Group's risk profile moves outside appetite.

More effective processes for reporting the results have also been developed, presenting the Board and senior management with a more holistic and dynamic view of key risk exposures.

Risk appetite is set at the RBS Group level then cascaded and embedded across all business areas. Each division is required to develop, own and manage a risk appetite statement aligned with the RBS Group's risk appetite and:

- Covers all identified material risks;
- Enables each business to understand its acceptable levels of risk; and
- Ensures that commercial strategies are aligned with the use of available financial resources.

By setting a clear risk appetite and embedding a strong risk culture throughout its businesses, the RBS Group can identify, measure and control risk exposures and respond effectively to shocks. Each division is responsible for ensuring its strategic plans are consistent with its approved risk appetite.

Risk control frameworks and their associated limits are an integral part of the risk appetite framework and a key part of embedding risk appetite targets in day-to-day risk management decisions. The risk control frameworks manage risk concentrations on a 'bottom-up' basis through portfolio and product limit setting, expressing a clear tolerance for material risk types that is aligned to business activities. These are aligned with a 'top-down' approach via a calibration of their aggregate contribution with the RBS Group's risk appetite targets (i.e. earnings volatility, capital and liquidity consumption and impact on stakeholder confidence).

The RBS Group Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in the RBS Group's risk control and governance. Its integrated approach is designed to ensure that an appropriate standard of control is set for each of the material risks the RBS Group faces, with an effective assurance process put in place to monitor and report on performance. Risk appetite has its own policy standard within the RBS Group Policy Framework that sets out clear roles and responsibilities to measure, cascade and report performance against risk appetite, as well as to provide assurances that business is being conducted within approved risk limits and tolerances.

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## Financial review *Risk and balance sheet management*

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### Culture, values and remuneration

#### Objectives for risk culture

Risk culture plays a key role in the RBS Group's ambition to build "a really good bank". A strong risk culture is a key part of ensuring risk appetite is effectively embedded across the RBS Group. The link between risk appetite and strategic objectives encourages people at all levels of the business to think about risk, how they identify it and how they manage it. It incorporates the quantitative and qualitative aspects of risk and uses both absolute and relative risk measures.

#### Risk culture policies

The RBS Group's values - of "serving customers well", "working together", "doing the right thing" and "thinking long term" - act as a clear starting point for a strong and effective risk culture. A wide range of communication and engagement activities (detailed below) has been undertaken to discuss the meaning of each value with employees and how they affect and guide day-to-day activities.

The embedding of the RBS Group's values into a strong risk culture is supported by a revised and more focused Code of Conduct. The Code provides guidance on expected behaviour and sets out the standards of conduct that support the RBS Group's values. It explains the effect of decisions that are taken and describes the principles that must be followed.

These business principles cover conduct related issues as well as wider business activities. They focus on desired outcomes, with practical guidelines to align the RBS Group's values with its commercial strategy and actions. The embedding of business principles facilitates sound decision making and a clear focus on good customer outcomes in 'the moments that matter'. It is aligned with the people management and remuneration processes to support a positive and strong risk culture through appropriate incentive structures.

#### Training

Across the risk management function, a series of events and activities have been undertaken to 'bring alive' the RBS Group's values and culture for employees. This is supported by performance management processes that hold individuals to account for poor behaviour and reward the behaviour that supports our purpose, visions and values.

#### Challenge mechanisms

A simple decision making guide (called the "YES check") has been included within the Code of Conduct. It is a simple, intuitive set of five questions, designed to ensure the values guide day-to-day decisions:

- Does what I am doing keep our customers and the Bank safe and secure?
- Would customers and colleagues say I am acting with integrity?
- Am I happy with how this would be perceived on the outside?
- Is what I am doing meeting the standards of conduct required?
- In five years time would others see this as a good way to work?

Each question is a prompt to think about the situation and how it fits with the RBS Group's values. It ensures that employees can think through decisions that don't have a clear answer, guiding the judgements behind their decisions and actions.

#### Risk-based key performance indicators

The RBS Group's policy standards require all current Code Staff roles to use a balanced scorecard approach to performance management. This ensures recognition of the longer-term business requirements and a balance between financial and non-financial metrics, including an evaluation of adherence to internal controls and risk management. Since 2011, all Code Staff roles have had specific risk objectives in their performance plan.

Unvested awards are subject to clawback and may be reduced, or forfeited in full, at the discretion of the RBS Group Performance and Remuneration Committee. For Code Staff roles, the Committee can apply clawback if the company, business area and team, or the individual subsequently incurs significant loss (either financial or reputational), or if the RBS Group as a whole suffers a material failure of risk management or material downturn in its financial performance.

Awards to employees under the RBS Group's long-term incentive plan are subject to financial and operational measures and an underlying requirement for effective risk management during the performance period.

The RBS Group Performance and Remuneration Committee has put in place a RBS Group-wide remuneration policy which is explicitly aligned with effective risk management. Performance is a key input into the determining of remuneration levels. RBS Group and divisional plans and targets are aligned with the risk appetite and the long-term interests of the RBS Group, as determined by the Board. These targets are the basis of RBS Group Executive members' objectives, which are approved by the RBS Group Performance and Remuneration Committee. These objectives are then cascaded through the divisions and functions.

There is significant focus on risk in performance assessment with all executives and Code Staff receiving specific risk feedback through an independent "360-degree" feedback process. As part of the line manager's assessment of individual performance divisional control functions, including risk, provide independent input to the line manager.



## Financial review *Risk and balance sheet management*

### Risk appetite\* continued

#### Culture, values and remuneration continued

#### Risk coverage

The RBS Group continued to strengthen its approach to risk management amid a challenging and ever-changing external environment in 2013. Areas of progress included:

- The completion of the phased roll-out of the RBS Group's conduct risk policies and of a more effective operating model, supported by the development and delivery of awareness initiatives and targeted training;
- The implementation of the enhanced country risk appetite framework, including top-down risk appetite, and of enhanced assurance processes;
- The introduction of a new integrated operating model for managing regulatory developments, which combines divisional and functional teams to leverage expertise more effectively; and
- Further strengthening of the RBS Group's credit risk management framework.

The main risk types faced by the Group are presented below, together with a summary of the key areas of focus and how the Group managed these risks in 2013. In preparing disclosures related to these risks, the Group has considered the recommendations of the Enhanced Disclosure Task Force issued in October 2012.

| Risk type                  | Definition                                                                                | Features                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                            |
|----------------------------|-------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Capital adequacy risk      | The risk that the RBS Group has insufficient capital.                                     | <p>Arises from: Inefficient management of capital resources.</p> <p>Character and impact: Characterised typically by credit risk losses.</p> <p>It has the potential to disrupt the business if there is insufficient capital to support business activities. It also has the potential to cause the RBS Group to fail to meet regulatory requirements. RBS Group capital and earnings may be affected, impairing the activities of all divisions.</p>                                                                                                                                                                                                                                         | <p>The Group's Core Tier 1 ratio on a Basel 2.5 basis was 9.8% at 31 December 2013, a 30 basis point improvement in the year despite absorbing RCR related impairments and RWA model updates.</p> <p>Refer to the Capital management section on pages 46 to 50 for further information.</p> |
| Liquidity and funding risk | The risk that the RBS Group is unable to meet its financial liabilities as they fall due. | <p>Arises from: The RBS Group's day-to-day operations.</p> <p>Character and impact: Dependent on company-specific factors such as maturity profile and composition of sources and uses of funding, the quality and size of the liquid asset buffer as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.</p> <p>It has the potential to cause the RBS Group to fail to meet regulatory liquidity requirements, become unable to support normal banking activity or at worst cease to be a going concern. Adverse impact on customer and investor confidence in the RBS Group and the wider financial system is also possible.</p> | <p>Liquidity and funding metrics continued to strengthen with external wholesale funding of £107.1 billion and a liquidity portfolio of £142.7 billion.</p> <p>Refer to the Liquidity and funding risk section on pages 51 to 61 for further information.</p>                               |

\*unaudited

## Financial review *Risk and balance sheet management*

| Risk type   | Definition                                                                                                                                                                                                                                                         | Features                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Credit risk | The risk of financial loss due to the failure of a customer, or counterparty, to meet its obligation to settle outstanding amounts.                                                                                                                                | <p>Arises from: Deterioration of the credit quality of customers or counterparties of the RBS Group, leaving them unable to meet their contractual obligations.</p> <p>Character and impact: Losses can vary materially across portfolios and may include the risk of loss due to the concentration of credit risk related to a specific product, asset class, sector or counterparty.</p> <p>It has the potential to affect adversely the RBS Group's financial performance and capital.</p>                                                                                                   | <p>During 2013, loan impairment charges were £8.5 billion, of which £4.5 billion related to the creation of RCR and the related strategy. Excluding the increased impairments related to RCR, loan impairment losses fell by £1.3 billion. Impairment provisions covered risk elements in lending of £39.1 billion by 64%, up from 51% a year earlier. Credit risk RWAs fell by 16% to £300.2 billion, within which counterparty risk RWAs more than halved to £22.5 billion, reflecting risk reduction and core product focus in Markets as well as Non-Core disposals and run-off.</p> <p>Credit risk is managed using a suite of credit approval, risk concentration, early warning and problem management frameworks as well as associated risk management tools.</p> <p>The focus in 2013 was on the calibration of the credit control framework to align with Group risk appetite targets and the enhancement of existing Basel models.</p> <p>Refer to the Credit risk and Balance sheet analysis sections on pages 62 to 156 for further information.</p> |
| Market risk | The risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors such as market volatilities that may lead to a reduction in earnings, economic value or both. | <p>Arises from: Adverse movements in market prices.</p> <p>Character and impact: Characterised by frequent small losses, which are material in aggregate, and infrequent large material losses due to stress events.</p> <p>It has the potential to materially affect financial performance in Markets, International Banking, Non-Core and RBS Group Treasury where the RBS Group has the majority of its exposures. The RBS Group's non-trading activities in retail and commercial businesses can also be affected through interest rate risk and foreign exchange non traded exposures.</p> | <p>During 2013, the Group continued to reduce its risk exposures. Average trading value-at-risk (VaR) decreased significantly from £98 million to £80 million, reflecting risk reduction and capital management focus. De-risking within the rates business and improvements in the capture of valuation adjustment risks within the counterparty exposure management desk in Markets helped reduce VaR in the first half of 2013. Ongoing reductions in the asset-backed securities inventory drove down the risk even further in the second half of 2013.</p> <p>Refer to the Market risk section on pages 157 to 172 for further information.</p>                                                                                                                                                                                                                                                                                                                                                                                                              |

\*unaudited

## Financial review *Risk and balance sheet management*

### Risk appetite\*: Risk coverage continued

| Risk type    | Definition                                                                                                                                                                      | Features                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Country risk | The risk of losses occurring as a result of either a country event or unfavourable country operating conditions.                                                                | <p>Arises from: Sovereign events, economic events, political events, natural disasters or conflicts.</p> <p>Character and impact: Primarily present in credit portfolios of Markets, International Banking, Ulster Bank (Ireland), RBS Group Centre (mainly Treasury), US Retail &amp; Commercial and Non-Core.</p> <p>It has the potential to affect parts of the RBS Group's credit portfolio that are directly or indirectly linked to the country in question.</p>                                                                                                                                                                                                                                                                                                   | <p>The RBS Group Country Risk Committee manages country risk matters including: risk appetite; risk management strategy and framework; risk exposure and policy; sovereign ratings; sovereign loss given default rates; and country Watchlist colours, with escalation where needed to the Executive Risk Forum.</p> <p>Regular, detailed reviews are carried out on all portfolios to ensure their composition remains in line with the RBS Group's country risk appetite and reflects economic and political developments.</p> <p>A country risk Watchlist process identifies emerging issues and assists in the development of mitigation strategies. In 2013, the scope of this process was widened to include all countries with RBS Group exposure.</p> <p>Balance sheet exposure to eurozone periphery countries continued to fall, and was down by 10% to £47.3 billion at the end of 2013, of which 78% related to Ireland, primarily reflecting exposures in Ulster Bank.</p> <p>Refer to the Country risk section on pages 173 to 185 for further information.</p> |
| Conduct risk | The risk that the conduct of the RBS Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss. | <p>Arises from: Breaches of regulatory rules or laws, resulting from the RBS Group's retail or wholesale conduct; or from failing to meet customers' or regulators' expectations of the RBS Group.</p> <p>Character and impact: Failures in product design, training and competence, complaint handling and transaction reporting can lead to an increase in complaints, compensation claims and regulatory censure.</p> <p>It has the potential to affect earnings (through loss of customer confidence and sales), as well as capital and liquidity (including regulator imposed fines for inappropriate conduct). It also affects the confidence of other key RBS Group stakeholders, such as private and institutional shareholders, regulators and governments.</p> | <p>Conduct risk is managed through the RBS Group's Conduct Risk Committee, under delegated authority from the Executive Risk Forum. The Committee is responsible for governance, leadership and risk appetite.</p> <p>The focus in 2013 was on placing conduct risk at the centre of the RBS Group's philosophy and on completing the development of the risk framework. Promoting understanding of conduct issues and ensuring compliance with regulations and rules are priorities for the RBS Group.</p> <p>Refer to the Conduct risk section on page 187 for further information.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

\*unaudited

## Financial review *Risk and balance sheet management*

| Risk type        | Definition                                                                                                                                                                                                                                                                                                                                                                                                                              | Features                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Pension risk     | The risk to a firm caused by its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees or for those of a related company or otherwise. It also means the risk that the firm will make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation, or because the firm considers that it needs to do so for some other reason. | <p>Arises from: Variation in value of pension scheme assets and liabilities owing to changes to life expectancy, interest rates, inflation, credit spreads, and equity and property prices.</p> <p>Character and impact: Pension schemes' funding positions can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities. The RBS Group might have to make financial contributions to, or with respect to, its pension schemes.</p> <p>It has the potential to adversely affect the RBS Group's funding and capital requirements.</p> | <p>The RBS Group's Pension Risk Committee considers the RBS Group's view of pension risk, mechanisms that could be used for managing pension risk and the financial strategy implications of the pension schemes as well as reviewing fund performance. The Committee reports to the RBS Group Asset and Liability Committee on the material pension schemes that the RBS Group is obliged to support.</p> <p>In 2013, various pension risk stress testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios designed to meet integrated PRA stress testing requirements.</p> <p>Refer to the Pension risk section on pages 188 and 189 for further information.</p>                      |
| Operational risk | The risk of loss resulting from inadequate or failed processes, people, systems or from external events.                                                                                                                                                                                                                                                                                                                                | <p>Arises from: The RBS Group's day-to-day operations and is relevant to every aspect of the RBS Group's business.</p> <p>Character and impact: May be financial in nature (characterised by either frequent small losses or infrequent material losses), or may lead to direct customer and/or reputational impact (for example, a major IT systems failure or fraudulent activity).</p> <p>It has the potential to affect the RBS Group's profitability and capital requirements directly, as well as stakeholder confidence.</p>                                                          | <p>Operational risk is managed by the Operational Risk Executive Committee. It is responsible for identifying and managing emerging operational risks, and for reviewing and monitoring operational risk profile strategies and frameworks, ensuring they are in line with risk appetite.</p> <p>In 2013, the focus was on continued implementation and embedding of risk assessments across the RBS Group, including the strengthening of links between risk assessments and other elements of the RBS Group operational risk framework. In addition, risk assessments were increasingly used to identify single points of failure.</p> <p>Refer to the Operational risk section on pages 189 to 191 for further information.</p> |

## Financial review *Risk and balance sheet management*

### Risk appetite\*: Risk coverage continued

| Risk type         | Definition                                                                                                                                                                                                                                                                                                     | Features                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Regulatory risk   | The risk of material loss or liability, legal or regulatory sanctions, or reputational damage, resulting from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards, in any location in which the RBS Group operates. | <p>Arises from: The RBS Group's regulatory, business or operating environment, and in how it responds to these.</p> <p>Character and impact: The crystallisation of regulatory risk can result in adverse impacts on the Group's customers, strategy, business, financial condition or reputation, for instance, through the failure to provide appropriate protections to customers, or from regulatory enforcement or other interventions.</p> <p>It has the potential to adversely impact the Group's customers, strategy, business, financial condition or reputation.</p> | <p>The management of regulatory (as well as conduct) risk is overseen by the Conduct and Regulatory Affairs function.</p> <p>The RBS Group's Compliance and Regulatory Affairs teams were brought together in the second half of 2013, following the creation of the role of RBS Group Head of Conduct and Regulatory Affairs. The Conduct and Regulatory Affairs function has responsibility for setting RBS Group wide policy and standards, providing advice to the business and ensuring controls are effective for managing regulatory affairs, compliance and financial crime risks across all businesses.</p> <p>Other enhancements were also made during 2013 included the creation of a more centralised approach to assurance activities and the introduction of a new 'Centres of Excellence' model for the management of regulatory developments, bringing together divisional and functional resources to manage issues more effectively.</p> <p>Refer to the Regulatory risk section on page 191 and 192 for further information.</p> |
| Reputational risk | The risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the RBS Group.                                                                                                                                                                                           | <p>Arises from: Actions taken (or, in some cases, not taken) by the RBS Group, as well as its wider policies and practices.</p> <p>Character and impact: Can result in an inability to build or sustain customer relationships, in low staff morale, in regulatory censure, or in reduced access to funding.</p>                                                                                                                                                                                                                                                               | <p>The reputational risk framework is aligned with the RBS Group's focus on serving customers well, strategic objectives and the risk appetite goal of maintaining stakeholder confidence.</p> <p>In 2013, the environmental, social and ethical risk management function was set up to address the reputational risk associated with the clients the RBS Group chooses to do business with. It sets policy and provides guidance to avoid reputational risk relating to business engagements and lending to clients in sensitive industry sectors.</p> <p>Refer to the Reputational risk section on pages 192 and 193 for further information.</p>                                                                                                                                                                                                                                                                                                                                                                                                 |
| Business risk     | The risk of losses as a result of adverse variance in the RBS Group's revenues and/or costs relative to its business plan and strategy.                                                                                                                                                                        | <p>Arises from: Internal factors such as volatility in pricing, sales volumes and input costs, and/or by external factors such as exposure to macroeconomic, regulatory and industry risks.</p> <p>Character and impact: Can lead to adverse changes in revenues and/or costs.</p> <p>It has the potential to directly affect the RBS Group's profitability and capital requirements, as well as stakeholder confidence.</p>                                                                                                                                                   | <p>The RBS Group Board has ultimate responsibility for business risk through the achievement of the RBS Group's business plan. The primary responsibility for divisional financial performance rests with the divisional CEO supported by divisional Executive Committee and functions.</p> <p>In 2013, the management and measurement of business risk was enhanced with an increased focus on stress testing.</p> <p>The RBS Group responded to business risk challenges by focusing on the management of net interest margin in order to sustain and grow revenues. In addition, it introduced cost management programmes to deliver substantial savings.</p> <p>Refer to the Business risk section on pages 193 and 194 for further information.</p>                                                                                                                                                                                                                                                                                            |

\*unaudited

## Financial review *Risk and balance sheet management*

| Risk type      | Definition                                                                                                                                                                             | Features                                                                                                                                                                                                             | How the Group manages risk and the focus in 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Strategic risk | The risk that the RBS Group will make inappropriate strategic choices, or that there will be changes in the external environment to which the RBS Group fails to adapt its strategies. | <p>Arises from: the RBS Group's management of its strategy.</p> <p>Character and impact: Varied losses affecting earnings, capital, liquidity and customer and stakeholder confidence. Can affect all divisions.</p> | <p>The RBS Group is focusing on reducing strategic risk following a wide-ranging review to analyse core activities and formulate an appropriate plan, including rationalisation where necessary, to address the business challenges of the next five years.</p> <p>The successful execution of this strategy is set against a background of increasing regulatory demands and scrutiny as well as a challenging macroeconomic environment. Successful and timely execution of the strategy will be key to the future success of the RBS Group.</p> <p>Refer to the Strategic risk section on pages 194 and 195 for further information.</p> |
| Political risk | The risk to the RBS Group's business and operations of the referendum on Scottish independence.                                                                                        |                                                                                                                                                                                                                      | <p>During 2013 the focus on the question of potential Scottish independence from the UK heightened, and the Scottish government will be holding a referendum in September 2014. A vote in favour of Scottish independence would be likely to impact the RBS Group's costs and could also impact the fiscal, legal and regulatory landscape to which the RBS Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the European Union.</p>                                                                                                                                                          |

|                    |                         |
|--------------------|-------------------------|
| Capital management |                         |
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## Financial review *Risk and balance sheet management*

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### Capital management\*

#### Definition

The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements, and operates within an agreed risk appetite. The appropriate level of capital is determined based on the dual aims of: (i) meeting minimum regulatory capital requirements; and (ii) ensuring the Group maintains sufficient capital to uphold customer, investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

#### 2013 overview

The Group reported a Core Tier 1 ratio of 9.8% as at 31 December 2013, 30 basis points higher than at the end of 2012. The benefit of lower RWAs was partially offset by the significant attributable loss for the year. The establishment of RCR and the related impairments was a significant contributing factor to the attributable loss.

RWA decreases were primarily in Markets as a result of balance sheet and risk reduction and in Non-Core reflecting disposal of capital intensive portfolios and run-off. Credit risk RWAs were £57.2 billion lower despite absorbing the adverse impact of model updates relating to exposure at default, commercial real estate slotting and loss given default changes to the shipping portfolio. Extension of product coverage improvements in models and reductions in weighting applied for exposure for default, contributed to the reduction in counterparty risk RWAs.

#### Regulatory developments

##### CRD IV

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

The Prudential Regulatory Authority (PRA) announced the acceleration of the end state rules for CET1 capital, whereby from 1 January 2014 the calculation is now closely aligned with the fully loaded definition. There will be no transitional arrangements applied to the prudential filters or regulatory deductions with the exception of unrealised gains on available for sale debt and equity which will be incorporated from 1 January 2015.

CRD IV and Basel III will impose a minimum CET1 ratio of 4.5% of RWAs. There are buffers which are likely to affect the Group: the capital conservation buffer set at 2.5%; the counter-cyclical capital buffer (up to 2.5% of RWAs), to be applied when macroeconomic conditions indicate areas of the economy are over-heating. Additional buffers may apply depending on domestic significance of banking group subsidiaries such as the Group. The regulatory target capital requirements will be phased in and are expected to apply in full from 1 January 2019, in the meantime using national discretion the PRA can apply a top-up. As set out in the PRA's Supervisory Statement SS3/13, the Group and other major UK banks and building societies are required to meet a CET1 ratio of 7% after taking into account certain adjustments set by the PRA.

PRA guidance indicates that from 1 January 2015, the Group must meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 capital. The Pillar 2A capital requirement is the additional capital that the Group must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Subordinated debt instruments which do not meet the new eligibility criteria will be grandfathered on a reducing basis over ten years.

The impact of implementing the CRD IV framework is likely to result in a lower CET1 ratio due to RWA uplifts relating to securitisations, credit valuation adjustments, asset valuation correlation and model and methodology changes, as well as capital changes.

#### Governance

##### Governance and approach

The Group Asset and Liability Management Committee (GALCO) is responsible for ensuring the RBS Group and its subsidiaries maintain adequate capital at all times. The Capital and Stress Testing Committee (CAST) is a cross-functional body driving and directing integrated risk capital activities including determination of the amount of capital the Group should hold, how and where capital is allocated and planning for actions that would ensure that an adequate capital position would be maintained in a stressed environment. These activities have linkages to capital planning, risk appetite and regulatory change. CAST reports through GALCO and comprises senior representatives from Risk Management, Group Finance and Group Treasury. Target capital ratios are set and monitored by the PRA for the Group. Management of capital is achieved by supervision of forecast capital and RWA over a five year time horizon.

##### Determining appropriate capital

The Group's own determination of sufficient capital is derived from the desired credit rating, risk appetite and reflects the current and emerging regulatory requirements of the legal entities within the RBS Group. It is evaluated through both internally and externally defined stress testing to identify potential changes in capital ratios in a range of scenarios.

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

The Group identifies the management and recovery actions that could be applied in stress environments. These form an important part of the capital management approach and the contingency planning arrangements, complementing the established buffers.

\*unaudited



## Financial review *Risk and balance sheet management*

### Capital management\* continued

#### Governance continued

##### Monitoring and maintenance

Based on these determinations, which are continually reassessed, the Group aims to maintain capital adequacy, both at Group level and in each regulated entity.

The Group operates a rigorous capital planning process aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital positions of the regulated entities and the overall Group. In the event that the projected position might deteriorate beyond acceptable levels, the Group would issue further capital and/or revise business plans accordingly.

Stress testing approaches are used to determine the level of capital required to ensure the Group expects to remain adequately capitalised.

#### Minimising surplus profits and capital

The Group has a process in place which requires surplus distributable profits of all Group subsidiaries, after making allowance for sufficient capital to support current and prospective growth in the following half-year, to be repatriated by way of a dividend on a half yearly basis and paid in cash before the period end. Surplus is defined as subsidiary capital of more than £1 million in excess of the regulatory minimum for UK banks and in accordance with the Group's policy, including capital buffers, or the industry specific/overseas regulatory requirements. However, fungibility of capital is subject to the approval of the local regulator.

### Capital allocation

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

The divisions use return on capital metrics when making pricing decisions on products and transactions to ensure customer activity is appropriately aligned with Group and divisional targets and allocations.

The PRA uses the risk asset ratio 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).

### Capital resources

The Group's capital, RWAs and risk asset ratios, on the basis of current rules (Basel 2.5) are set out below.

| Current rules<br>Capital                                      | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---------------------------------------------------------------|-------------|-------------|-------------|
| Core Tier 1                                                   | 36.0        | 41.6        | 36.5        |
| Core Tier 1 (excluding Asset Protection Scheme (APS) in 2011) | 36.0        | 41.6        | 39.3        |
| Tier 1                                                        | 41.8        | 48.3        | 43.7        |
| Total                                                         | 63.9        | 67.6        | 58.2        |

#### RWAs by risk

|                    |       |       |        |
|--------------------|-------|-------|--------|
| Credit risk        |       |       |        |
| - non-counterparty | 277.7 | 310.0 | 311.9  |
| - counterparty     | 22.5  | 47.4  | 59.7   |
| Market risk        | 28.8  | 39.3  | 59.4   |
| Operational risk   | 37.5  | 41.4  | 37.0   |
|                    | 366.5 | 438.1 | 468.0  |
| APS relief         | —     | —     | (69.1) |
|                    | 366.5 | 438.1 | 398.9  |

#### Risk asset ratios

|                                     | %    | %    | %    |
|-------------------------------------|------|------|------|
| Core Tier 1                         | 9.8  | 9.5  | 9.2  |
| Core Tier 1 (excluding APS in 2011) | 9.8  | 9.5  | 8.4  |
| Tier 1                              | 11.4 | 11.0 | 11.0 |
| Total                               | 17.4 | 15.4 | 14.6 |

\*unaudited

## Financial review *Risk and balance sheet management*

The Group's regulatory capital resources in accordance with PRA definitions were as follows:

|                                                                   | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------------------------------------------|------------|------------|------------|
| <b>Shareholders' equity (excluding non-controlling interests)</b> |            |            |            |
| Shareholders' equity                                              | 48,786     | 59,288     | 61,726     |
| Other equity instruments                                          | (1,421)    | (1,421)    | (1,421)    |
|                                                                   | 47,365     | 57,867     | 60,305     |
| <b>Non-controlling interests</b>                                  | 79         | 137        | 128        |
| <b>Regulatory adjustments and deductions</b>                      |            |            |            |
| Own credit                                                        | 1,519      | 1,563      | (1,157)    |
| Defined benefit pension fund adjustment                           | 362        | 913        | —          |
| Net unrealised AFS gains                                          | (359)      | (1,750)    | (2,220)    |
| Cash flow hedging reserve                                         | 86         | (1,815)    | (1,018)    |
| Other regulatory adjustments                                      | 50         | 10         | (230)      |
| Goodwill and other intangible assets                              | (12,352)   | (12,403)   | (12,365)   |
| 50% of expected losses less impairment provisions                 | (54)       | (1,954)    | (2,553)    |
| 50% of securitisation positions                                   | (722)      | (1,001)    | (1,605)    |
| 50% of APS first loss                                             | —          | —          | (2,763)    |
|                                                                   | (11,470)   | (16,437)   | (23,911)   |
| <b>Core Tier 1 capital</b>                                        | 35,974     | 41,567     | 36,522     |
| <b>Other Tier 1 capital</b>                                       |            |            |            |
| Preference shares - debt                                          | 2,745      | 2,759      | 2,857      |
| Innovative/hybrid Tier 1 securities                               | 3,502      | 3,551      | 3,645      |
|                                                                   | 6,247      | 6,310      | 6,502      |
| <b>Tier 1 deductions</b>                                          |            |            |            |
| 50% of material holdings                                          | (409)      | (239)      | (235)      |
| Tax on expected losses less impairment provisions                 | 16         | 634        | 920        |
|                                                                   | (393)      | 395        | 685        |
| <b>Total Tier 1 capital</b>                                       | 41,828     | 48,272     | 43,709     |

\*unaudited

## Financial review *Risk and balance sheet management*

### Capital management\* continued

#### Capital resources continued

|                                                       | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------------------------------|------------|------------|------------|
| <b>Qualifying Tier 2 capital</b>                      |            |            |            |
| Undated subordinated debt                             | 4,716      | 4,814      | 4,916      |
| Dated subordinated debt - net of amortisation         | 18,371     | 18,121     | 17,272     |
| Unrealised gains on AFS equity shares                 | 111        | 40         | 106        |
| Collectively assessed impairment provisions           | 375        | 379        | 584        |
| Non-controlling Tier 2 capital                        | —          | —          | 11         |
|                                                       | 23,573     | 23,354     | 22,889     |
| <b>Tier 2 deductions</b>                              |            |            |            |
| 50% of securitisation positions                       | (722)      | (1,001)    | (1,605)    |
| 50% of standardised losses less impairment provisions | (70)       | (2,588)    | (3,473)    |
| 50% of material holdings                              | (409)      | (239)      | (235)      |
| 50% of APS first loss                                 | —          | —          | (2,763)    |
|                                                       | (1,201)    | (3,828)    | (8,076)    |
| <b>Total Tier 2 capital</b>                           | 22,372     | 19,526     | 14,813     |
| <b>Supervisory deductions</b>                         |            |            |            |
| Unconsolidated investments                            | (36)       | (37)       | (111)      |
| Other deductions                                      | (217)      | (193)      | (184)      |
|                                                       | (253)      | (230)      | (295)      |
| <b>Total regulatory capital</b>                       | 63,947     | 67,568     | 58,227     |

\*unaudited

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## **Financial review** *Risk and balance sheet management*

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### **Liquidity and funding risk**

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## Financial review *Risk and balance sheet management*

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### Liquidity and funding risk

#### Definition

Liquidity and funding risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as and when they fall due.

The risk arises through the maturity transformation role that banks perform. It is dependent on company specific factors such as maturity profile, composition of sources and uses of funding, the quality and size of the liquidity portfolio as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

#### Liquidity risk

##### Policy, framework and governance

The Group's liquidity policy reflects internal appetite, best market practice and complies with prevailing regulatory structures. These policies are designed to address three broad issues which ensure that:

- The Group's main legal entities maintain adequate liquid resources at all times to meet liabilities as they fall due.
- The Group maintains an adequate liquid asset portfolio appropriate to the business activities of the Group and its risk profile.
- The Group has in place robust strategies, policies, systems, and procedures for identifying, measuring, monitoring and managing liquidity risk.
- The Group has a comprehensive liquidity risk management framework in place to ensure the Group maintains an appropriate level of financial resources to meet its financial obligations as and when they fall due.

The risk management framework determines the sources of liquidity risk and the steps the Group can take when these risks exceed certain actively monitored limits. These actions include when and how to use the Group's liquidity reserves and what other adjustments to the Group's balance sheet should be undertaken to manage these risks within the Group's risk appetite.

The Group's appetite for liquidity risk is set by the Board as a percentage of the Individual Liquidity Adequacy Assessment (ILAA) stressed outflows and then managed on a daily basis by various functions within the business with liquidity risk controlled at legal entity, country, regional and divisional levels.

In setting risk limits the Board takes into account the nature of the Group's various activities, the Group's overall risk appetite, market best practice and regulatory compliance.

The Group Asset and Liability Management Committee (GALCo) sets and reviews the liquidity risk management framework and limits within the risk appetite set by the Group Board. GALCo oversees the implementation of liquidity management across the Group. Each significant legal entity has a nominated Legal Entity Liquidity Risk Owner (LELRO) who is responsible for managing the liquidity risk for their legal entity. Group Treasury conducts the review, challenge and reporting of the Group's liquidity performance, while GALCo's management of liquidity risk is overseen by the Executive Risk Forum, Executive Committee and the Group Board.

#### Regulatory oversight\*

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

The Group's principal regulator, the PRA, has a comprehensive set of liquidity policies, the cornerstone of which is Policy Statement (PS) 09/16. In order to comply with the PRA regulatory process, the Group:

- At least annually, completes and keeps updated an ILAA;
- Undertakes the Focused Liquidity Review process which is a comprehensive review of the Group's ILAA, liquidity policies and operational capacity and capability. This in turn leads to the Group and the PRA agreeing the parameters of Group's Individual Liquidity Guidance (ILG) which influences the overall size of the Group's liquidity portfolio.

In addition, the Group's US operations meet liquidity requirements set out by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Financial Industry Regulatory Authority. In the Republic of Ireland, Ulster Bank Ireland Limited is subject to oversight from the Central Bank of Ireland.

In January 2013, the Basel Committee on Banking Supervision ("BCBS") issued its revised draft guidance for calculating the Liquidity Coverage Ratio (LCR), which is currently expected to come into force from 1 January 2015 on a phased basis.

At present there is a broad range of interpretations on how to calculate both the NSFR and the LCR due to the lack of commonly agreed technical standards. The Group continues to assess the impact of these consultations and actively communicates with regulators and industry groups. Assumptions will be refined as regulatory interpretations evolve.

\*unaudited

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## Financial review *Risk and balance sheet management*

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Under the EU Capital Requirements Regulation (CRR) to implement the recommended guidance of Basel 3, the European Banking Authority (EBA) is tasked with issuing a set of technical standards for implementing the LCR within the EU, to be ratified by the European Commission before 30 June 2014. The LCR metric will come into effect as a minimum standard from 1 January 2015.

The PRA has issued a statement proposing to retain the existing ILG framework until 31 December 2014, whilst the EBA's implementation of the LCR is finalised.

### Measurement and monitoring

In implementing the Group's liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. The limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

To foster appropriate pricing behaviour, decision making and balance sheet composition Group Treasury uses transfer pricing of liquidity and funding costs, limits and parameters. This ensures liquidity and funding risk is reflected in the measurement of divisional business performance and ensures divisions are being correctly incentivised to source the most appropriate mix of funding.

The Board's determination and quantification of the appetite for liquidity risk is primarily determined by reference to the ILAA which includes a comparison of the size of liquidity portfolio to an assessment of stressed outflows. The ILAA also informs the Board and PRA of the Group's liquidity risks, their mitigation and about the current and future liquidity profile.

Within the liquidity portfolio the Group holds cash at central banks, high quality government securities and collateral eligible for use in central bank operations, such as the Bank of England's Discount Window Facility.

In determining what assets should be held within the liquidity portfolio, the liquidity risk management framework dictates minimum internal quality criteria, level of currency diversification and maturity mix. The liquidity value of an asset is generally determined by reference to the haircut that would be applied by a central bank operation or in private repurchase agreement.

The Group actively monitors a range of market-wide and firm-specific early warning indicators of emerging liquidity stresses. Indicators include such areas as customer deposit outflows, market funding costs and movements in the Group's credit default swap premiums. Early warning indicators and regulatory metrics are reported daily to senior management.

Liquidity risks are reviewed at a significant legal entity level daily and performance reported to legal entity, divisional and Group Asset and Liability Management Committees at least monthly. Any breach of internal metric limits will set in motion a series of actions and escalations that could lead to activation of the Group's Contingency Funding Plan.

In November 2013, the Group's credit rating was downgraded by Standard & Poor's. Prior to this event, the Group undertook an intensive internal review of the magnitude of a rating downgrade on customer and counterparty behaviours and these included stress testing and scenario modelling. This analysis was also shared with the PRA. Following the downgrade by Standard & Poor's, there was minimal impact on customer or counterparty behaviour, the primary reason for deposit withdrawals was due to contractual downgrade triggers or the rating no longer meeting the customer or counterparty's investment requirements.

### Stress testing and contingency planning\*

Liquidity stress tests apply scenario-based behavioural and contractual assumptions to cash inflows and outflows to assess the level of liquidity reserves required under a particular scenario.

A stress event can occur when either firm-specific or market-wide factors or a combination of both lead to depositors and investors withdrawing or not renewing funding on maturity. This could be caused by many factors including fears over the viability of the firm. Additionally, liquidity stress can be brought on by customers choosing to draw down on loan agreements and facilities.

Simulated liquidity stress testing is performed at least quarterly for each division as well as the major operating subsidiaries in order to evaluate the strength of the Group's liquidity risk management.

Stress tests are designed to examine the impact of a variety of firm-specific and market-wide scenarios on the future adequacy of the Group's liquidity reserves. Stress test scenarios are designed to take into account the Group's experiences during the financial crisis, recent market conditions and events. These scenarios can be run at any time in response to the emergence of firm-specific or market-wide risks that could have a material impact on the Group's liquidity position. In the past these have included credit rating changes and political and economic conditions changing in particular countries.

In determining the adequacy of the Group's liquidity resources the Group focuses on the outflows it anticipates as a result of any stress scenario occurring. These outflows are measured over certain time periods which extend from two weeks to three months. The Group is expected to be able to withstand these stressed outflows through its own resources (primarily through the use of the liquidity portfolio) without having to resort to extraordinary central bank or governmental assistance.

The Group's liquidity risk appetite is measured by reference to the liquidity portfolio as a percentage of stressed contractual and behavioural outflows under the worst of three severe stress scenarios, as prescribed by the PRA. These are a market-wide stress, an idiosyncratic stress and a combination of both.

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Liquidity risk continued

#### Stress testing and contingency planning\* continued

##### Key liquidity risk stress testing assumptions

- *Net wholesale funding* - Outflows at contractual maturity of wholesale funding, with no rollover/new issuance, prime brokerage, 100% loss of excess client derivative margin and 100% loss of excess client cash.
- *Secured financing and increased haircuts* - Loss of secured funding capacity at contractual maturity date and incremental haircut widening, depending upon collateral type.
- *Retail and commercial bank deposits* - Substantial outflows as the Group could be seen as a greater credit risk than competitors.
- *Intra-day cashflows* - Liquid collateral held against intra-day requirement at clearing and payment systems is regarded as encumbered with no liquidity value assumed. Liquid collateral is held against withdrawal of unsecured intra-day lines provided by third parties.
- *Intra-group commitments and support* - Risk of cash within subsidiaries becoming unavailable to the wider Group and contingent calls for funding on Group Treasury from subsidiaries and affiliates.
- *Funding concentrations* - Additional outflows recognised against concentration of providers of wholesale secured financing.
- *Off-balance sheet activities* - Collateral outflows due to market movements, and all collateral owed by the Group to counterparties but not yet called; anticipated increase in firm's derivative initial margin requirement in stress scenarios; collateral outflows contingent upon a multi-notch credit rating downgrade of Group firms; drawdown on committed facilities provided to corporates, based on counterparty type, creditworthiness and facility type; and drawdown on retail commitments.
- *Franchise viability* - Group liquidity stress testing includes additional liquidity in order to meet outflows that are non-contractual in nature, but are necessary in order to support valuable franchise businesses.
- *Management action* - Unencumbered marketable assets that are held outside of the Core liquidity portfolio and are of verifiable liquidity value to the firm, are assumed to be monetised (subject to haircut/valuation adjustment).

The Group has a Contingency Funding Plan (CFP), which is updated at least annually and as the balance sheet evolves and forms the basis of analysis and actions to remediate adverse events as and if they arise. The CFP provides a detailed description of the availability, size and timing of all sources of contingent liquidity available to the Group in a stress event. These are ranked in order of economic impact and effectiveness to meet the anticipated stress requirement. The CFP includes documented processes for actions that may be required to meet the outflows and specifies roles and responsibilities for the effective implementation of the CFP.

\*unaudited

### Liquidity reserves

Liquidity risks are mitigated by the Group's centrally managed liquidity portfolio. The size of the portfolio is determined under the Group's liquidity risk management framework with reference to the Group's risk appetite.

The majority of the portfolio is centrally managed by Group Treasury, ring-fenced from the Markets trading book, and is the ultimate responsibility of the Group Treasurer. This portfolio is held in the PRA regulated UK Defined Liquidity Group (UK DLG) comprising the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Co and Adam & Company.

Certain of the Group's significant operating subsidiaries - RBS Citizens Financial Group Inc. and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations but differ from PRA rules. These portfolios are the responsibility of the local Treasurer who reports to the Group Treasurer.

The UK DLG liquidity portfolio accounted for c88% of the Group's total liquidity portfolio, this portion is available to meet liquidity needs as they arise across the Group. The remaining liquidity reserves are held locally within non-UK bank subsidiaries, the majority of this portion is restricted by regulatory requirements and therefore assumed to be restricted and only be available for use locally.

Separately from the liquidity portfolio, the Group holds high quality assets to meet payment systems collateral requirements, these assets are not freely available to other areas of the Group.

The Group categorises its liquidity portfolio, including its locally managed liquidity portfolios, into primary and secondary liquid assets.

Primary liquid assets generally comprise eligible liquid assets, such as cash and balances at central banks, treasury bills and other high quality government and US agency bonds.

Secondary liquid assets comprise other assets that are eligible as collateral for local central bank liquidity facilities but do not meet the core local regulatory definition. These assets include own-issued securitisations or whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

The composition of the liquidity portfolio is influenced by quality of counterparty, maturity mix and currency mix. The PRA rules dictate certain minimum quality standards for the UK DLG liquidity portfolio. The liquidity value of the portfolio is determined with reference to current market prices and the haircuts necessary to generate cash from the asset.

The Group in consultation with the PRA and subject to the requirements of the PRA's ILG can change the composition of its liquidity portfolio. The change in composition may relate to market specific factors, changes in internal liquidity risk mix or regulatory guidance.

## Financial review *Risk and balance sheet management*

### Liquidity portfolio

The table below analyses the Group's liquidity portfolio by product, liquidity value and carrying value. Liquidity value is lower than carrying value as it is stated after the discounts applied by the Bank of England and other central banks to instruments, within the secondary liquidity portfolio, eligible for discounting.

|                                              | Liquidity value  |               |             |             |               |             |               |             |               |  |
|----------------------------------------------|------------------|---------------|-------------|-------------|---------------|-------------|---------------|-------------|---------------|--|
|                                              | 2013             |               |             |             |               | 2012        |               | 2011        |               |  |
|                                              | UK DLG (1)<br>£m | CFG (1)<br>£m | Other<br>£m | Total<br>£m | Average<br>£m | Total<br>£m | Average<br>£m | Total<br>£m | Average<br>£m |  |
| Cash and balances at central banks           | 71,121           | 824           | 44          | 71,989      | 77,196        | 65,751      | 71,290        | 57,932      | 65,881        |  |
| Central and local government bonds           |                  |               |             |             |               |             |               |             |               |  |
| AAA rated governments                        | 3,320            | —             | —           | 3,320       | 4,784         | 9,338       | 18,133        | 29,632      | 34,114        |  |
| AA- to AA+ rated governments and US agencies | 5,822            | 6,369         | —           | 12,191      | 12,130        | 9,189       | 8,026         | 14,102      | 1,682         |  |
| governments rated below AA                   | —                | —             | —           | —           | —             | —           | —             | —           | 4             |  |
| local governments                            | —                | —             | —           | —           | —             | —           | —             | —           | 15            |  |
|                                              | 9,142            | 6,369         | —           | 15,511      | 16,914        | 18,527      | 26,159        | 43,734      | 35,815        |  |
| Treasury bills                               | —                | —             | —           | —           | 395           | 750         | 202           | —           | 5,937         |  |
| Primary liquidity                            | 80,263           | 7,193         | 44          | 87,500      | 94,505        | 85,028      | 97,651        | 101,666     | 107,633       |  |
| Secondary liquidity (2)                      | 48,718           | 4,968         | 1,527       | 55,213      | 56,040        | 55,416      | 40,001        | 30,181      | 27,557        |  |
| Total liquidity portfolio                    | 128,981          | 12,161        | 1,571       | 142,713     | 150,545       | 140,444     | 137,652       | 131,847     | 135,190       |  |
| Carrying value                               | 159,743          | 17,520        | 3,431       | 180,694     |               | 180,207     |               | 169,904     |               |  |

The table below shows the currency split of the liquidity portfolio.

| Total liquidity portfolio | GBP<br>£m | USD<br>£m | EUR<br>£m | Other<br>£m | Total<br>£m |
|---------------------------|-----------|-----------|-----------|-------------|-------------|
| 2013                      | 100,849   | 32,531    | 7,844     | 1,489       | 142,713     |
| 2012                      | 84,570    | 32,525    | 22,518    | 831         | 140,444     |
| 2011                      | 48,839    | 50,082    | 30,855    | 2,071       | 131,847     |

#### Notes:

(1) The PRA regulated UK Defined Liquidity Group (UK DLG) comprises the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company plc. In addition, certain of the Group's significant operating subsidiaries - RBS Citizens Financial Group Inc. (CFG) and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations that may differ from PRA rules.

(2) Includes assets eligible for discounting at the Bank of England and other central banks.



## Financial review *Risk and balance sheet management*

### Funding risk

#### Funding sources

The Group's primary funding source is its customer deposit base, primarily built through its retail and commercial franchises in the UK, Ireland and the US. These deposits form a stable base which fully funds the Group's customer lending activities.

Complementary to its deposit funding, the Group also accesses various wholesale markets for funding, on both a public and private basis. These include long-term secured and unsecured debt, short-term money markets and repurchase agreements. The Group has set policies for the prudent use of wholesale funding, as part of its wider liquidity policies.

Maintaining access to global capital markets provides the Group's funding base with diversity. Over time the Group's wholesale funding mix has been diversified by currency, geography, maturity and type. The Group accesses the wholesale funding markets directly or through its main operating subsidiaries via established funding programmes. The use of different entities to access the market from time to time allows the Group to further diversify its funding mix and in certain limited circumstances demonstrate to regulators that specific operating subsidiaries enjoy market access in their own right.

The Group may access various funding facilities offered by central banks from time to time. The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of the Group's broader liquidity management and funding strategy. Overall usage and repayment of available central bank facilities will fit within the Group's overall liquidity risk appetite and concentration limits.

During 2013, the Group repaid €5.0 billion of the original €6.5 billion borrowed under the European Central Bank's Long Term Refinancing Operation. The remaining balance is used to fund certain of the Group's Eurozone banking subsidiaries and the usage of this facility will be evaluated on an ongoing basis. The Group has not drawn down any additional funds under the Bank of England's Funding for Lending Scheme during the year and has repaid the initial drawing of £750 million in order to manage its excess cash position. The Group remains committed to supporting the objectives of the Funding for Lending scheme.

### Analysis

#### Funding sources

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

#### Wholesale funding

The table below summarises funding metrics.

|      | Short-term wholesale funding (1)       |                                        | Total wholesale funding                |                                        | Net inter-bank funding (2) |                  |                               |
|------|----------------------------------------|----------------------------------------|----------------------------------------|----------------------------------------|----------------------------|------------------|-------------------------------|
|      | Excluding derivative collateral<br>£bn | Including derivative collateral<br>£bn | Excluding derivative collateral<br>£bn | Including derivative collateral<br>£bn | Deposits<br>£bn            | Loans (3)<br>£bn | Net inter-bank funding<br>£bn |
| 2013 | 29.8                                   | 48.1                                   | 111.1                                  | 129.4                                  | 15.8                       | (15.3)           | 0.5                           |
| 2012 | 33.7                                   | 61.3                                   | 147.4                                  | 175.1                                  | 24.2                       | (14.3)           | 9.9                           |
| 2011 | 84.7                                   | 115.6                                  | 212.5                                  | 243.4                                  | 27.4                       | (14.1)           | 13.3                          |

#### Notes:

(1) Short-term wholesale balances denote those with a residual maturity of less than one year and include longer-term issuances.

(2) Excludes derivative collateral.

(3) Primarily short-term balances.

## Financial review *Risk and balance sheet management*

The table below shows the Group's principal funding sources excluding repurchase agreements.

|                                                        | 2013              |                                                                          |             | 2012              |                                                                          |             | 2011              |                                                                          |             |
|--------------------------------------------------------|-------------------|--------------------------------------------------------------------------|-------------|-------------------|--------------------------------------------------------------------------|-------------|-------------------|--------------------------------------------------------------------------|-------------|
|                                                        | Third party<br>£m | Amounts due<br>to holding<br>company<br>and fellow<br>subsidiaries<br>£m | Total<br>£m | Third party<br>£m | Amounts due<br>to holding<br>company<br>and fellow<br>subsidiaries<br>£m | Total<br>£m | Third party<br>£m | Amounts due<br>to holding<br>company<br>and fellow<br>subsidiaries<br>£m | Total<br>£m |
| <b>Deposits by banks</b>                               |                   |                                                                          |             |                   |                                                                          |             |                   |                                                                          |             |
| derivative cash collateral                             | 18,300            | —                                                                        | 18,300      | 27,631            | —                                                                        | 27,631      | 30,884            | —                                                                        | 30,884      |
| other deposits                                         | 15,788            | 2,463                                                                    | 18,251      | 24,243            | 6,063                                                                    | 30,306      | 27,368            | 11,945                                                                   | 39,313      |
|                                                        | 34,088            | 2,463                                                                    | 36,551      | 51,874            | 6,063                                                                    | 57,937      | 58,252            | 11,945                                                                   | 70,197      |
| <b>Debt securities in issue</b>                        |                   |                                                                          |             |                   |                                                                          |             |                   |                                                                          |             |
| conduit asset-backed commercial paper (ABCP)           | —                 | —                                                                        | —           | —                 | —                                                                        | —           | 11,164            | —                                                                        | 11,164      |
| other commercial paper (CP)                            | 435               | —                                                                        | 435         | 806               | —                                                                        | 806         | 3,031             | —                                                                        | 3,031       |
| certificates of deposit (CDs)                          | 2,276             | —                                                                        | 2,276       | 2,907             | —                                                                        | 2,907       | 14,422            | —                                                                        | 14,422      |
| medium-term notes (MTNs)                               | 40,657            | —                                                                        | 40,657      | 58,152            | —                                                                        | 58,152      | 88,405            | —                                                                        | 88,405      |
| covered bonds                                          | 9,041             | —                                                                        | 9,041       | 10,139            | —                                                                        | 10,139      | 9,107             | —                                                                        | 9,107       |
| securitisations                                        | 7,337             | —                                                                        | 7,337       | 11,274            | —                                                                        | 11,274      | 14,708            | —                                                                        | 14,708      |
|                                                        | 59,746            | —                                                                        | 59,746      | 83,278            | —                                                                        | 83,278      | 140,837           | —                                                                        | 140,837     |
| <b>Subordinated liabilities</b>                        | 13,309            | 19,825                                                                   | 33,134      | 15,667            | 18,184                                                                   | 33,851      | 16,552            | 15,772                                                                   | 32,324      |
| <b>Notes issued</b>                                    | 73,055            | 19,825                                                                   | 92,880      | 98,945            | 18,184                                                                   | 117,129     | 157,389           | 15,772                                                                   | 173,161     |
| <b>Wholesale funding</b>                               | 107,143           | 22,288                                                                   | 129,431     | 150,819           | 24,247                                                                   | 175,066     | 215,641           | 27,717                                                                   | 243,358     |
| <b>Customer deposits</b>                               |                   |                                                                          |             |                   |                                                                          |             |                   |                                                                          |             |
| derivative cash collateral                             | 7,048             | —                                                                        | 7,048       | 7,941             | —                                                                        | 7,941       | 9,025             | —                                                                        | 9,025       |
| other deposits                                         | 406,782           | 5,207                                                                    | 411,989     | 417,499           | 5,778                                                                    | 423,277     | 393,827           | 3,179                                                                    | 397,006     |
| <b>Total customer deposits</b>                         | 413,830           | 5,207                                                                    | 419,037     | 425,440           | 5,778                                                                    | 431,218     | 402,852           | 3,179                                                                    | 406,031     |
| <b>Total funding</b>                                   | 520,973           | 27,495                                                                   | 548,468     | 576,259           | 30,025                                                                   | 606,284     | 618,493           | 30,896                                                                   | 649,389     |
| <b>Disposal group customer deposits included above</b> |                   |                                                                          | 3,190       |                   |                                                                          | 18          |                   |                                                                          | 21,820      |

### Key points

- Third party wholesale funding decreased by nearly 29% in the year to £107 billion principally reflecting strategic downsizing in Markets.
- The ratio of customer deposits (excluding third party derivative cash collateral) as a proportion of total external funding continues to improve and was 78% at the end of 2013.

## Financial review *Risk and balance sheet management*

### Funding risk: Analysis continued

#### Notes issued

The table below shows the Group's debt securities in issue and subordinated liabilities by residual maturity.

|                   | Debt securities in issue |                        |            |                     |                       |             | Subordinated liabilities<br>£m | Total notes issued<br>£m | Total notes issued<br>% |
|-------------------|--------------------------|------------------------|------------|---------------------|-----------------------|-------------|--------------------------------|--------------------------|-------------------------|
|                   | Conduit ABCP<br>£m       | Other CP and CDs<br>£m | MTNs<br>£m | Covered bonds<br>£m | Securitisations<br>£m | Total<br>£m |                                |                          |                         |
| <b>2013</b>       |                          |                        |            |                     |                       |             |                                |                          |                         |
| Less than 1 year  | —                        | 2,647                  | 9,748      | 1,853               | 514                   | 14,762      | 1,378                          | 16,140                   | 17                      |
| 1-3 years         | —                        | 59                     | 11,051     | 3,621               | —                     | 14,731      | 3,244                          | 17,975                   | 19                      |
| 3-5 years         | —                        | —                      | 5,427      | 867                 | —                     | 6,294       | 3,455                          | 9,749                    | 11                      |
| More than 5 years | —                        | 5                      | 14,431     | 2,700               | 6,823                 | 23,959      | 25,057                         | 49,016                   | 53                      |
|                   | —                        | 2,711                  | 40,657     | 9,041               | 7,337                 | 59,746      | 33,134                         | 92,880                   | 100                     |
| <b>2012</b>       |                          |                        |            |                     |                       |             |                                |                          |                         |
| Less than 1 year  | —                        | 3,323                  | 9,425      | 1,038               | 761                   | 14,547      | 2,385                          | 16,932                   | 15                      |
| 1-3 years         | —                        | 384                    | 17,684     | 2,948               | 500                   | 21,516      | 4,624                          | 26,140                   | 22                      |
| 3-5 years         | —                        | 1                      | 12,300     | 2,380               | —                     | 14,681      | 1,055                          | 15,736                   | 13                      |
| More than 5 years | —                        | 5                      | 18,743     | 3,773               | 10,013                | 32,534      | 25,787                         | 58,321                   | 50                      |
|                   | —                        | 3,713                  | 58,152     | 10,139              | 11,274                | 83,278      | 33,851                         | 117,129                  | 100                     |
| <b>2011</b>       |                          |                        |            |                     |                       |             |                                |                          |                         |
| Less than 1 year  | 11,164                   | 17,173                 | 32,278     | —                   | 27                    | 60,642      | 684                            | 61,326                   | 35                      |
| 1-3 years         | —                        | 278                    | 19,702     | 2,760               | 479                   | 23,219      | 3,389                          | 26,608                   | 15                      |
| 3-5 years         | —                        | 1                      | 13,236     | 3,673               | —                     | 16,910      | 4,971                          | 21,881                   | 13                      |
| More than 5 years | —                        | 1                      | 23,189     | 2,674               | 14,202                | 40,066      | 23,280                         | 63,346                   | 37                      |
|                   | 11,164                   | 17,453                 | 88,405     | 9,107               | 14,708                | 140,837     | 32,324                         | 173,161                  | 100                     |

#### Deposits and repos

The table below shows the composition of the Group's deposits and repos.

|                                        | 2013           |             | 2012           |             | 2011           |             |
|----------------------------------------|----------------|-------------|----------------|-------------|----------------|-------------|
|                                        | Deposits<br>£m | Repos<br>£m | Deposits<br>£m | Repos<br>£m | Deposits<br>£m | Repos<br>£m |
| <b>Financial institutions</b>          |                |             |                |             |                |             |
| - central and other banks              | 36,551         | 28,583      | 57,937         | 44,323      | 70,197         | 38,900      |
| - other financial institutions         | 57,973         | 52,945      | 64,435         | 86,940      | 63,370         | 86,032      |
| <b>Personal and corporate deposits</b> | 361,064        | 3,541       | 366,783        | 1,057       | 342,661        | 2,145       |
|                                        | 455,588        | 85,069      | 489,155        | 132,320     | 476,228        | 127,077     |

#### Customer loan:deposit ratios and funding surplus

The table below shows customer loans, deposits, loan:deposit ratios (LDR) and customer funding surplus.

|             | Loans (1)<br>£m | Deposits (2)<br>£m | LDR<br>% | Funding surplus/(gap)<br>£m |
|-------------|-----------------|--------------------|----------|-----------------------------|
| <b>2013</b> | 388,272         | 413,830            | 94       | 25,558                      |
| <b>2012</b> | 423,191         | 425,440            | 99       | 2,249                       |
| <b>2011</b> | 446,073         | 402,852            | 111      | (43,221)                    |

#### Notes:

- (1) Excludes reverse repurchase agreements and net of impairment provisions.  
(2) Excludes repurchase agreements.

## Financial review *Risk and balance sheet management*

### Encumbrance

The Group reviews all assets against the criteria of being able to finance them in a secured form (encumbrance) but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity, predictable and measurable cash flows, and a consistent and uniform underwriting and collection process. Retail assets including residential mortgages, credit card receivables and personal loans display many of these features.

From time to time the Group encumbers assets to serve as collateral to support certain wholesale funding initiatives. The three principal forms of encumbrance are own asset securitisations, covered bonds and securities repurchase agreements.

The Group categorises its assets into three broad groups; assets that are:

- already encumbered and used to support funding currently in place via own asset securitisations, covered bonds and securities repurchase agreements.
- not currently encumbered but can for instance be used to access funding from market counterparties or central bank facilities as part of the Group's contingency funding.
- not currently encumbered. In this category, the Group has in place an enablement programme which seeks to identify assets which are capable of being encumbered and to identify the actions to facilitate such encumbrance whilst not impacting customer relationships or servicing.

The Group's encumbrance ratios are set out below.

| Encumbrance ratios                                                              | 2013<br>% | 2012<br>% | 2011<br>% |
|---------------------------------------------------------------------------------|-----------|-----------|-----------|
| Total                                                                           | 17        | 18        | 20        |
| Excluding balances relating to derivative transactions                          | 19        | 22        | 28        |
| Excluding balances relating to derivative and securities financing transactions | 12        | 12        | 21        |

## Financial review *Risk and balance sheet management*

### Funding risk: Encumbrance continued

#### Balance sheet encumbrance

|                                                         | Encumbered assets relating to:         |                         |                           |              |                            |                                          | Encumbered<br>assets %<br>of related<br>assets<br>% | Unencumbered                  |                            |                                       |                                | Balances<br>with holding<br>company<br>and fellow<br>subsidiaries |      | Total   |
|---------------------------------------------------------|----------------------------------------|-------------------------|---------------------------|--------------|----------------------------|------------------------------------------|-----------------------------------------------------|-------------------------------|----------------------------|---------------------------------------|--------------------------------|-------------------------------------------------------------------|------|---------|
|                                                         | Debt securities in issue               |                         | Other secured liabilities |              |                            | Total<br>encumbered<br>assets (1)<br>£bn |                                                     | Readily realisable (2)        |                            | Cannot<br>be (4)<br>encumbered<br>£bn | Total<br>third<br>party<br>£bn |                                                                   |      |         |
|                                                         | Securitisations<br>and conduits<br>£bn | Covered<br>bonds<br>£bn | Derivatives<br>£bn        | Repos<br>£bn | Secured<br>deposits<br>£bn |                                          |                                                     | Liquidity<br>portfolio<br>£bn | Other<br>realisable<br>£bn |                                       |                                |                                                                   |      |         |
| 2013                                                    | £bn                                    | £bn                     | £bn                       | £bn          | £bn                        | £bn                                      | %                                                   | £bn                           | £bn                        | £bn                                   | £bn                            | £bn                                                               | £bn  | £bn     |
| Cash and balances at<br>central banks                   | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | 71.9                          | 8.1                        | —                                     | —                              | 80.0                                                              | —    | 80.0    |
| Loans and advances<br>to banks                          | 5.8                                    | 0.5                     | 9.7                       | —            | —                          | 16.0                                     | 64                                                  | 0.1                           | 8.9                        | —                                     | —                              | 25.0                                                              | 15.1 | 40.1    |
| Loans and advances to<br>customers                      |                                        |                         |                           |              |                            |                                          |                                                     |                               |                            |                                       |                                |                                                                   |      |         |
| - UK residential mortgages                              | 14.6                                   | 16.2                    | —                         | —            | —                          | 30.8                                     | 28                                                  | 60.8                          | 18.6                       | —                                     | —                              | 110.2                                                             | —    | 110.2   |
| - Irish residential<br>mortgages                        | 9.3                                    | —                       | —                         | —            | 1.2                        | 10.5                                     | 70                                                  | 0.7                           | 3.8                        | —                                     | 0.1                            | 15.1                                                              | —    | 15.1    |
| - US residential mortgages                              | —                                      | —                       | —                         | —            | 3.5                        | 3.5                                      | 18                                                  | 9.5                           | 6.7                        | —                                     | —                              | 19.7                                                              | —    | 19.7    |
| - UK credit cards                                       | 3.4                                    | —                       | —                         | —            | —                          | 3.4                                      | 52                                                  | —                             | 3.1                        | —                                     | —                              | 6.5                                                               | —    | 6.5     |
| - UK personal loans                                     | 3.4                                    | —                       | —                         | —            | —                          | 3.4                                      | 38                                                  | —                             | 5.5                        | —                                     | —                              | 8.9                                                               | —    | 8.9     |
| - other                                                 | 12.9                                   | —                       | 17.8                      | —            | 0.8                        | 31.5                                     | 14                                                  | 4.4                           | 9.6                        | 172.2                                 | 10.2                           | 227.9                                                             | 1.6  | 229.5   |
| Reverse repurchase<br>agreements and<br>stock borrowing | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 76.3                           | 76.3                                                              | —    | 76.3    |
| Debt securities                                         | 0.9                                    | —                       | 5.2                       | 52.0         | 2.3                        | 60.4                                     | 60                                                  | 15.9                          | 24.3                       | —                                     | —                              | 100.6                                                             | 0.1  | 100.7   |
| Equity shares                                           | —                                      | —                       | 0.5                       | 5.1          | —                          | 5.6                                      | 67                                                  | —                             | 2.7                        | —                                     | —                              | 8.3                                                               | —    | 8.3     |
| Settlement balances                                     | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 5.6                            | 5.6                                                               | —    | 5.6     |
| Derivatives                                             | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 286.0                          | 286.0                                                             | 3.4  | 289.4   |
| Intangible assets                                       | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 12.4                           | 12.4                                                              | —    | 12.4    |
| Property, plant and<br>equipment                        | —                                      | —                       | —                         | —            | 0.4                        | 0.4                                      | 5                                                   | —                             | —                          | 7.5                                   | —                              | 7.9                                                               | —    | 7.9     |
| Deferred tax                                            | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 3.4                            | 3.4                                                               | —    | 3.4     |
| Prepayments, accrued<br>income and other assets         | —                                      | —                       | —                         | —            | —                          | —                                        | —                                                   | —                             | —                          | —                                     | 5.9                            | 5.9                                                               | —    | 5.9     |
|                                                         | 50.3                                   | 16.7                    | 33.2                      | 57.1         | 8.2                        | 165.5                                    |                                                     | 163.3                         | 91.3                       | 179.7                                 | 399.9                          | 999.7                                                             | 20.2 | 1,019.9 |
| Own asset securitisations                               |                                        |                         |                           |              |                            |                                          |                                                     | 17.4                          |                            |                                       |                                |                                                                   |      |         |
| Total liquidity portfolio                               |                                        |                         |                           |              |                            |                                          |                                                     | 180.7                         |                            |                                       |                                |                                                                   |      |         |

#### Notes:

- (1) Loans and advances have been assigned to remote limited partnerships to provide security for debt issuances by the RBS Group.
- (2) Encumbered assets are those on the balance sheet that have been pledged to provide security for the liability shown above and are therefore not available to secure funding or to meet other collateral needs.
- (3) Unencumbered readily realisable assets are those assets on the balance sheet that can be readily used to meet funding or collateral requirements and comprise:
  - (a) Liquidity portfolio: cash balances at central banks, high quality debt securities and loans that have been pre-positioned with central banks. In addition, the liquidity portfolio includes securitisations of own assets which has reduced over the years and has been replaced by loans.
  - (b) Other readily realisable assets: other liquidity reserves, including assets that have been enabled for use with central banks; and unencumbered debt securities.
- (4) Unencumbered other realisable assets are those assets on the balance sheet that have no restrictions for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.
- (5) Assets that cannot be encumbered comprise:
  - (a) derivatives, reverse repurchase agreements and trading related settlement balances.
  - (b) non-financial assets such as intangibles, prepayments and deferred tax.
  - (c) assets in disposal groups.
  - (d) loans that cannot be pre-positioned with central banks based on criteria set by the central banks, primarily US, including date of origination and level of documentation.
  - (e) non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral.
- (6) In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

## Financial review *Risk and balance sheet management*

| 2012                                              | Encumbered assets relating to:      |                      |                           |              |                         |                                | Encumbered assets<br>% of related assets<br>% | Unencumbered               |              | Total third party<br>£bn | Balances with holding company and fellow subsidiaries<br>£bn | Total<br>£bn |
|---------------------------------------------------|-------------------------------------|----------------------|---------------------------|--------------|-------------------------|--------------------------------|-----------------------------------------------|----------------------------|--------------|--------------------------|--------------------------------------------------------------|--------------|
|                                                   | Debt securities in issue            |                      | Other secured liabilities |              |                         | Total encumbered assets<br>£bn |                                               | Liquidity portfolio<br>£bn | Other<br>£bn |                          |                                                              |              |
|                                                   | Securitisations and conduits<br>£bn | Covered bonds<br>£bn | Derivatives<br>£bn        | Repos<br>£bn | Secured deposits<br>£bn |                                |                                               |                            |              |                          |                                                              |              |
| Cash and balances at central banks                | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | 65.8                       | 8.7          | 74.5                     | —                                                            | 74.5         |
| Loans and advances to banks                       | 5.3                                 | 0.5                  | 11.6                      | —            | —                       | 17.4                           | 68                                            | —                          | 8.3          | 25.7                     | 21.9                                                         | 47.6         |
| Loans and advances to customers                   |                                     |                      |                           |              |                         |                                |                                               |                            |              |                          |                                                              |              |
| - UK residential mortgages                        | 16.4                                | 16.0                 | —                         | —            | —                       | 32.4                           | 30                                            | 58.7                       | 18.0         | 109.1                    | —                                                            | 109.1        |
| - Irish residential mortgages                     | 10.6                                | —                    | —                         | —            | 1.8                     | 12.4                           | 81                                            | —                          | 2.9          | 15.3                     | —                                                            | 15.3         |
| - US residential mortgages                        | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | 7.6                        | 14.1         | 21.7                     | —                                                            | 21.7         |
| - UK credit cards                                 | 3.0                                 | —                    | —                         | —            | —                       | 3.0                            | 44                                            | —                          | 3.8          | 6.8                      | —                                                            | 6.8          |
| - UK personal loans                               | 4.7                                 | —                    | —                         | —            | —                       | 4.7                            | 62                                            | —                          | 2.9          | 7.6                      | —                                                            | 7.6          |
| - other                                           | 19.9                                | —                    | 22.2                      | —            | 0.8                     | 42.9                           | 16                                            | 6.6                        | 212.9        | 262.4                    | 1.9                                                          | 264.3        |
| Reverse repurchase agreements and stock borrowing | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 104.5        | 104.5                    | —                                                            | 104.5        |
| Debt securities                                   | 1.0                                 | —                    | 8.3                       | 87.2         | 7.3                     | 103.8                          | 76                                            | 18.9                       | 13.7         | 136.4                    | 0.2                                                          | 136.6        |
| Equity shares                                     | —                                   | —                    | 0.7                       | 6.8          | —                       | 7.5                            | 54                                            | —                          | 6.4          | 13.9                     | —                                                            | 13.9         |
| Settlement balances                               | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 5.7          | 5.7                      | —                                                            | 5.7          |
| Derivatives                                       | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 437.9        | 437.9                    | 7.2                                                          | 445.1        |
| Intangible assets                                 | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 12.4         | 12.4                     | —                                                            | 12.4         |
| Property, plant and equipment                     | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 9.7          | 9.7                      | —                                                            | 9.7          |
| Deferred tax                                      | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 3.1          | 3.1                      | —                                                            | 3.1          |
| Prepayments, accrued income and other assets      | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 6.1          | 6.1                      | —                                                            | 6.1          |
| Assets of disposal groups                         | —                                   | —                    | —                         | —            | —                       | —                              | —                                             | —                          | 0.3          | 0.3                      | —                                                            | 0.3          |
|                                                   | 60.9                                | 16.5                 | 42.8                      | 94.0         | 9.9                     | 224.1                          |                                               | 157.6                      | 871.4        | 1,253.1                  | 31.2                                                         | 1,284.3      |
| Own asset securitisations                         |                                     |                      |                           |              |                         |                                |                                               | 22.6                       |              |                          |                                                              |              |
| Total liquidity portfolio                         |                                     |                      |                           |              |                         |                                |                                               | 180.2                      |              |                          |                                                              |              |
| Liabilities secured                               |                                     |                      |                           |              |                         |                                |                                               |                            |              |                          |                                                              |              |
| Inter-Group - used for secondary liquidity        | (22.6)                              | —                    | —                         | —            | —                       | (22.6)                         |                                               |                            |              |                          |                                                              |              |
| Inter-Group - other                               | (23.9)                              | —                    | —                         | —            | —                       | (23.9)                         |                                               |                            |              |                          |                                                              |              |
| Third party (1)                                   | (11.3)                              | (10.1)               | (56.7)                    | (132.3)      | (12.4)                  | (222.8)                        |                                               |                            |              |                          |                                                              |              |
|                                                   | (57.8)                              | (10.1)               | (56.7)                    | (132.3)      | (12.4)                  | (269.3)                        |                                               |                            |              |                          |                                                              |              |

Note:  
(1) In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

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## **Financial review** *Risk and balance sheet management*

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### **Credit risk**

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## Financial review *Risk and balance sheet management*

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### Credit risk

#### Definition

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

#### Sources of credit risk

The Group is exposed to credit risk as a result of a wide range of business activities. The most significant source of credit risk is lending. The second most significant source is counterparty credit risk, which results from the Group's activities in the derivatives and securities financing transaction markets.

The Group offers a number of lending products where it has an irrevocable obligation to provide credit facilities to a customer. Security may be obtained to mitigate the risk of loss in the form of physical collateral, such as commercial real estate assets and residential property, or financial collateral such as cash or bonds. Also included in the Group's lending are exposures arising from leasing activities.

Derivatives and securities financing transactions expose the Group to counterparty credit risk, which is the risk of loss arising from a failure of a customer to meet obligations which vary in value by reference to a market factor.

The Group holds debt securities with the intention of selling them and so is exposed to market risk. However, it also holds some debt securities generally for liquidity management purposes, and is exposed to credit risk as a result.

The Group is exposed to credit risk from off-balance sheet products such as trade finance activities and guarantees.

#### Credit risk governance

A strong credit risk management function is vital to support the ongoing profitability of the Group. The potential for loss is mitigated through a robust credit risk culture in the business units and through a focus on sustainable lending practices. The RBS Group's credit risk management function is responsible for credit approval and managing concentration risk, as well as credit risk control frameworks and acts as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound credit environment.

The RBS Group Chief Credit Officer (GCCO), through the RBS Group Credit Risk (GCR) function, is responsible for the development of, and ensuring compliance with, RBS Group-wide policies and credit risk frameworks as well as RBS Group-wide assessment of provision adequacy. The risk management functions, located in the Group's business divisions, are responsible for the execution of these policies.

The divisional credit risk management functions work together with GCR to ensure that the risk appetite set by the RBS Group Board is met. The credit risk function in each division is managed by a Chief Credit Officer, who reports jointly to a divisional Chief Risk Officer and to the GCCO. Divisional credit risk management activities include transaction analysis, credit approval, ongoing credit risk stewardship, and early problem identification and management.

The Executive Risk Forum (ERF) considers and approves material aspects of the Group's credit risk management framework, such as credit risk appetite and limits for portfolios of strategic significance. The ERF has delegated approval authority to the RBS Group Credit Risk Committee, a functional sub-committee of the RBS Group Risk Committee, to act on credit risk matters. These include, but are not limited to, credit risk appetite and limits (within the overall risk appetite set by the RBS Board and the ERF), credit risk strategy and frameworks, credit risk policy and the oversight of the credit profile across the RBS Group. There are separate Group Credit Risk Committees for the retail and wholesale portfolios and these are chaired by the GCCO.

The RBS Group Audit Committee (GAC) provides oversight of the Group's provision adequacy. The GCCO is accountable to the GAC for the adequacy of the Group's provisions, both individual and collective. The RBS Group Provisions Committee, which is chaired by either the Group Chief Risk Officer or the GCCO, approves recommendations from the divisional provisions committees.

Key trends in the credit risk profile of the RBS Group, performance against limits and emerging risks are set out in the RBS Risk Management Monthly Report provided to the Executive Committee, the Board Risk Committee and the Group Board.

#### Risk appetite and concentration framework

Risk appetite is set using specific quantitative targets under stress, including earnings volatility and capital adequacy. The Group's credit risk framework has therefore been designed around the factors that influence the Group's ability to meet those targets. These include product and asset class, industry sector, single name and country concentrations. Any of these factors could generate higher earnings volatility under stress and, if not adequately controlled, could undermine capital adequacy. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between the RBS Group risk appetite targets and the credit risk control framework. The frameworks are supported by a suite of RBS Group-wide and divisional policies that set out the risk parameters within which divisions must operate. The RBS Group also manages its exposures to counterparty credit risk closely, using portfolio limits and specific tools to control more volatile or capital intensive business areas.

#### Wholesale

Four formal frameworks are used to manage wholesale credit concentration risk. The RBS Group continually reassesses its frameworks to ensure that they remain appropriate for its varied business franchises and current economic conditions, as well as to reflect further refinements in the RBS Group's risk measurement models.



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## Financial review *Risk and balance sheet management*

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### Credit risk continued

#### Risk management\*

##### Product/asset class concentration framework

The Group manages certain lines of business where the nature of credit risk assumed could result in a concentration or a heightened risk in some other form. This includes specific credit risk types such as settlement or wrong-way risk and products such as long-dated derivatives or securitisations. These product and asset classes may require formal policies and expertise as well as tailored monitoring and reporting measures. In some cases specific limits and thresholds are deployed to ensure that the credit risk inherent in these lines of business and products is adequately controlled. Product and asset classes are reviewed regularly. The reviews consider the risks inherent in each product or asset class, the risk controls applied, monitoring and reporting of the risk, the client base, and any emerging risks to ensure risk appetite remains appropriate.

##### Sector concentration

Exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Risk appetite and portfolio strategies are set at either the sector or sub-sector level, depending on where exposures may result in excessive concentration, or where trends in both external factors and internal portfolio performance give cause for concern. Regular formal reviews are undertaken at RBS Group or divisional level depending on materiality. Reviews may include an assessment of the RBS Group's franchise in a particular sector, an analysis of the outlook, identification of key vulnerabilities or stress testing.

As a result of the reviews carried out in 2013, the RBS Group further reduced its risk appetite in the corporate sectors of commercial real estate and retail. For further details on sector-specific strategies, exposure reduction and key credit risks, refer to pages 80 to 95.

##### Single name concentration

A single name concentration (SNC) framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes elevated approval authority, additional reporting and monitoring, and the requirement for plans to address exposures in excess of appetite.

Several credit risk mitigation techniques are available to reduce single name concentrations. If the Group decides that its exposure is too high, it may decide to sell excess exposures. Alternatively, it may decide to take additional security or guarantees such as cash, bank or government guarantees or enter into credit default swaps. Credit risk mitigants must be effective in terms of legal certainty and enforceability. In addition, maturity or expiry dates must be the same, or later, than the underlying obligations.

Aggregate SNC exposures remain outside of the Group's longer-term appetite. However, material reductions have been achieved since the framework was introduced. This trend continued during the year, with a 21% decrease in the number of excesses since December 2012.

##### Country concentration

The country concentration framework is described in the Country risk section on pages 173 to 185.

##### Retail

A product and asset class framework exists to control credit risk for retail businesses. It sets limits that measure and control the asset quality of each key business area, the portfolios in that business and the new business being originated. The actual performance of each portfolio is tracked relative to these limits and action taken where necessary.

##### Credit risk assessment

###### Wholesale

The credit risk function assesses, approves and manages the credit risk associated with a borrower or group of related borrowers.

The GCCO has established a framework of individual delegated authorities, which are set out in the RBS Group Credit Risk Policy. The framework requires at least two individuals to approve each credit decision, one from the business and one from the credit risk function. Both must hold appropriate delegated authority, which is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the framework. While both parties are accountable for the quality of each decision taken, the credit risk approver holds ultimate sanctioning authority.

In all circumstances the risks associated with any proposal to provide, increase, review or change the terms or conditions of credit facilities must be assessed prior to a credit decision being made. Assessments of credit risk must, at a minimum, specifically address the following elements:

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with applicable RBS Group and/or divisional credit policies;
- The customer's ability to meet obligations, based on an analysis of financial information and a review of payment and covenant compliance history;
- The source of repayment and the customer's risk profile, including sector analysis and sensitivity to economic and market developments, and credit risk mitigation;
- Refinancing risk - that is the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;
- Consideration of all other risks such as environmental, social and ethical, regulatory and reputational risks; and
- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed divisional risk appetite.

\*unaudited

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## Financial review *Risk and balance sheet management*

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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; compliance with terms and conditions; and refinancing risk.

### *Retail*

Retail lending entails making a large number of small value loans. To ensure that it makes these lending decisions consistently, the RBS Group analyses the historical debt servicing behaviour of customers, including their behaviour with respect to their other lenders. The RBS Group then uses the results of these analyses to set its lending rules, developing different rules for different products. The resulting credit decision making process is then largely automated, with customers receiving a credit score that reflects the outcome of a comparison of their credit profile with the rule set. However, in the case of relatively high value, complex personal or small business loans, including some residential mortgage lending, specialist credit managers make the final lending decisions.

### *Controls and assurance*

The RBS Group's credit control and assurance framework has three key components: credit policy; policy compliance assurance; and independent assurance. These apply to both wholesale and retail credit risk at both portfolio and individual customer level.

The first component is the RBS Group Credit Policy Standard, which is part of the RBS Group Policy Framework. It sets out the rules the RBS Group's businesses must follow to ensure that credit risks are identified and effectively managed through the credit lifecycle.

The second component is a policy assurance activity that GCR undertakes to provide the GCCO with evidence of the effectiveness of credit risk management controls in place across the Group. The results of these reviews are presented to the Group Credit Risk Committee on a regular basis in support of the self-certification that GCR must complete from time to time.

The third component of the RBS Group's credit assurance framework is the Credit Quality Assurance (CQA) function. CQA independently reviews the RBS Group's lending activities to identify control breaches, assess portfolio quality and recommend process improvements. These findings are escalated to senior management and plans to address shortcomings are recorded and tracked in the RBS Group's operational risk system. CQA's activities are overseen by GAC and the results of its reviews are regularly shared with the RBS Group's main regulators.

### *Risk measurement\**

#### *Credit risk models*

The RBS Group uses credit risk models in the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. These may be divided into three categories:

#### *Probability of default (PD)*

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

- Wholesale models - A number of credit grading models are in place that consider risk characteristics relevant to different customer types. These models use a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance or sector outlook. As part of the credit assessment process, the Group assigns each customer an internal credit grade based on its PD.
- Retail models - Each customer account is scored and models are used to assign a PD. Inputs vary across portfolios and include both internal account and customer level data, as well as data from credit bureaus. This score is used to support automated credit decision making through the use of a statistically derived scorecard.

#### *Exposure at default (EAD)*

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

#### *Loss given default (LGD)*

LGD models estimate the amount that cannot be recovered in the event of customer default. When estimating LGD, the Group's models assess both borrower and facility characteristics, as well as various credit risk mitigants. The cost of collections and a time discount factor for the delay in cash recovery are also incorporated.

#### *Changes to credit models*

The RBS Group reviews and updates models on an ongoing basis, reflecting more recent data, changes to products and portfolios, and updated regulatory requirements. Extensive changes were made to wholesale models in 2012 and 2013. This process continues with further changes, notably in banks and corporate exposure classes, planned for 2014.

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

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

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Credit risk: Risk measurement\* continued

#### Economic capital

The credit economic capital model is an extensive framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes.

The model takes into account migration risk (risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's creditworthiness has a significant impact on the creditworthiness of a business operating in that country).

#### Risk mitigation

Risk mitigation techniques are used in the management of credit portfolios across the RBS Group, typically to mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, the Group nets customer credit balances against obligations.

Mitigation tools applied can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties.

When seeking to mitigate risk, at a minimum the Group considers the following:

- The suitability of the proposed risk mitigation, particularly if restrictions apply;
- The means by which legal certainty is to be established, including required documentation, supportive legal opinions and the steps needed to establish legal rights;
- Acceptable methodologies for initial and subsequent valuation of collateral, the frequency of valuation and the advance rates given;
- The actions it can take if the value of collateral or other mitigants is less than needed;
- The risk that the value of mitigants and counterparty credit quality may deteriorate simultaneously;
- The need to manage concentration risks arising from collateral types; and
- The need to ensure that any risk mitigation remains legally effective and enforceable.

The RBS Group's business and credit teams are supported by specialist in-house documentation teams. The Group uses industry-standard loan and security documentation wherever possible. However, when the Group uses non-standard documentation, external lawyers are employed on a case-by-case basis.

#### Lending

The types of collateral the Group takes to mitigate the credit risk arising from wholesale lending varies according to the nature of the counterparty and its assets. The most common types are:

- Commercial real estate - The market value of the collateral typically exceeds the loan amount at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer. In Ireland and, to a lesser extent, the UK, a lack of market data has made estimating the value of property difficult and so causes the Group to use a range of other types of information to value such collateral, including expert judgement and indices. For further information, regarding the Group's commercial real estate portfolio refer to pages 80 to 85.
- Residential property - The Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages and home equity lending. The Group values residential property during the loan underwriting process by either appraising properties individually or using statistically valid models. The Group updates residential property values quarterly using the relevant residential property index, namely the Halifax Quarterly Regional House Price Index in the UK, the Case-Shiller Home Price Index in the US, the Central Statistics Office Residential Property Price Index in the ROI, and the Nationwide House Price Index in Northern Ireland.
- Physical assets - These may include stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of different ways, depending on the type of asset concerned and may rely on balance sheet valuations in certain cases. In the US, the Group also takes collateral in the form of motor vehicles to mitigate the credit risk arising from automobile lending. The Group values new vehicles at cost and used ones at the relevant average trade-in value.
- Receivables - These are amounts owed to the Group's counterparties by their own customers. The Group values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.

All collateral is assessed case-by-case to ensure that it will retain its value independently of the provider. The Group monitors the value of the collateral and, if there is a shortfall, will seek additional collateral.

\*unaudited

## Financial review Risk and balance sheet management

The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value ratio, which represents loan value before provisions relative to the value of the property financed.

| Commercial real estate<br>loan-to-value ratio | Ulster Bank      |                      |             | Rest of the Group |                      |             | Group            |                      |             |
|-----------------------------------------------|------------------|----------------------|-------------|-------------------|----------------------|-------------|------------------|----------------------|-------------|
|                                               | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m  | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m |
| 2013                                          |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 124              | 23                   | 147         | 7,884             | 262                  | 8,146       | 8,008            | 285                  | 8,293       |
| > 50% and <= 70%                              | 271              | 55                   | 326         | 9,962             | 582                  | 10,544      | 10,233           | 637                  | 10,870      |
| > 70% and <= 90%                              | 282              | 89                   | 371         | 3,699             | 1,272                | 4,971       | 3,981            | 1,361                | 5,342       |
| > 90% and <= 100%                             | 86               | 154                  | 240         | 865               | 368                  | 1,233       | 951              | 522                  | 1,473       |
| > 100% and <= 110%                            | 121              | 212                  | 333         | 690               | 627                  | 1,317       | 811              | 839                  | 1,650       |
| > 110% and <= 130%                            | 238              | 366                  | 604         | 333               | 1,334                | 1,667       | 571              | 1,700                | 2,271       |
| > 130% and <= 150%                            | 102              | 438                  | 540         | 267               | 1,161                | 1,428       | 369              | 1,599                | 1,968       |
| > 150%                                        | 319              | 6,738                | 7,057       | 150               | 2,629                | 2,779       | 469              | 9,367                | 9,836       |
| Total with LTVs                               | 1,543            | 8,075                | 9,618       | 23,850            | 8,235                | 32,085      | 25,393           | 16,310               | 41,703      |
| Minimal security (1)                          | 6                | 3,144                | 3,150       | 54                | 13                   | 67          | 60               | 3,157                | 3,217       |
| Other (2)                                     | 144              | 1,351                | 1,495       | 5,230             | 933                  | 6,163       | 5,374            | 2,284                | 7,658       |
| Total                                         | 1,693            | 12,570               | 14,263      | 29,134            | 9,181                | 38,315      | 30,827           | 21,751               | 52,578      |
| Total portfolio average LTV (3)               | 121%             | 376%                 | 335%        | 61%               | 149%                 | 84%         | 65%              | 261%                 | 142%        |
| 2012 (4)                                      |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 141              | 18                   | 159         | 7,210             | 281                  | 7,491       | 7,351            | 299                  | 7,650       |
| > 50% and <= 70%                              | 309              | 58                   | 367         | 12,161            | 996                  | 13,157      | 12,470           | 1,054                | 13,524      |
| > 70% and <= 90%                              | 402              | 164                  | 566         | 6,438             | 1,042                | 7,480       | 6,840            | 1,206                | 8,046       |
| > 90% and <= 100%                             | 404              | 137                  | 541         | 1,542             | 2,145                | 3,687       | 1,946            | 2,282                | 4,228       |
| > 100% and <= 110%                            | 111              | 543                  | 654         | 1,019             | 1,449                | 2,468       | 1,130            | 1,992                | 3,122       |
| > 110% and <= 130%                            | 340              | 619                  | 959         | 901               | 1,069                | 1,970       | 1,241            | 1,688                | 2,929       |
| > 130% and <= 150%                            | 353              | 774                  | 1,127       | 322               | 913                  | 1,235       | 675              | 1,687                | 2,362       |
| > 150%                                        | 1,000            | 7,350                | 8,350       | 595               | 1,962                | 2,557       | 1,595            | 9,312                | 10,907      |
| Total with LTVs                               | 3,060            | 9,663                | 12,723      | 30,188            | 9,857                | 40,045      | 33,248           | 19,520               | 52,768      |
| Minimal security (1)                          | 8                | 1,615                | 1,623       | 3                 | 13                   | 16          | 11               | 1,628                | 1,639       |
| Other (2)                                     | 137              | 811                  | 948         | 6,494             | 1,191                | 7,685       | 6,631            | 2,002                | 8,633       |
| Total                                         | 3,205            | 12,089               | 15,294      | 36,685            | 11,061               | 47,746      | 39,890           | 23,150               | 63,040      |
| Total portfolio average LTV (3)               | 136%             | 286%                 | 250%        | 65%               | 125%                 | 80%         | 71%              | 206%                 | 122%        |
| 2011                                          |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 272              | 32                   | 304         | 7,091             | 332                  | 7,423       | 7,363            | 364                  | 7,727       |
| > 50% and <= 70%                              | 479              | 127                  | 606         | 14,105            | 984                  | 15,089      | 14,584           | 1,111                | 15,695      |
| > 70% and <= 90%                              | 808              | 332                  | 1,140       | 10,042            | 1,191                | 11,233      | 10,850           | 1,523                | 12,373      |
| > 90% and <= 100%                             | 438              | 201                  | 639         | 2,616             | 1,679                | 4,295       | 3,054            | 1,880                | 4,934       |
| > 100% and <= 110%                            | 474              | 390                  | 864         | 1,524             | 1,928                | 3,452       | 1,998            | 2,318                | 4,316       |
| > 110% and <= 130%                            | 527              | 1,101                | 1,628       | 698               | 1,039                | 1,737       | 1,225            | 2,140                | 3,365       |
| > 130% and <= 150%                            | 506              | 1,066                | 1,572       | 239               | 912                  | 1,151       | 745              | 1,978                | 2,723       |
| > 150%                                        | 912              | 7,472                | 8,384       | 433               | 2,082                | 2,515       | 1,345            | 9,554                | 10,899      |
| Total with LTVs                               | 4,416            | 10,721               | 15,137      | 36,748            | 10,147               | 46,895      | 41,164           | 20,868               | 62,032      |
| Minimal security (1)                          | 72               | 1,086                | 1,158       | —                 | —                    | —           | 72               | 1,086                | 1,158       |
| Other (2)                                     | 193              | 625                  | 818         | 8,994             | 1,844                | 10,838      | 9,187            | 2,469                | 11,656      |
| Total                                         | 4,681            | 12,432               | 17,113      | 45,742            | 11,991               | 57,733      | 50,423           | 24,423               | 74,846      |
| Total portfolio average LTV (3)               | 120%             | 264%                 | 222%        | 69%               | 129%                 | 82%         | 75%              | 203%                 | 116%        |

### Notes:

- (1) In 2012, the RBS Group reclassified loans with limited (defined as LTV>1,000%) or non-physical security as minimal security, of which a majority were commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect the relevant asset quality and recovery profile.
- (2) Other non-performing loans of £2.3 billion (2012 - £2.0 billion; 2011 - £2.5 billion) were subject to the RBS Group's standard provisioning policies. Other performing loans of £5.4 billion (2012 - £6.6 billion; 2011 - £9.2 billion) included general corporate loans, typically unsecured, to commercial real estate companies, and major UK house builders in addition to facilities supported by guarantees. The credit quality of these exposures was consistent with that of the performing portfolio overall.
- (3) Weighted average by exposure.
- (4) 2012 LTV revised to reflect refinement to security value reporting implemented during 2013.

## Financial review Risk and balance sheet management

### Credit risk continued

#### Risk mitigation continued

| Corporate risk elements in lending and potential problem loans<br>(excluding commercial real estate) | 2013        |                  | 2012        |                  | 2011        |                  |
|------------------------------------------------------------------------------------------------------|-------------|------------------|-------------|------------------|-------------|------------------|
|                                                                                                      | Loans<br>£m | Provisions<br>£m | Loans<br>£m | Provisions<br>£m | Loans<br>£m | Provisions<br>£m |
| Secured                                                                                              | 7,656       | 4,336            | 9,787       | 4,614            | 7,206       | 2,925            |
| Unsecured                                                                                            | 2,321       | 1,588            | 1,429       | 874              | 1,582       | 1,179            |

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

| Loan-to-value ratio                                 | UK Retail        |                      |             | Ulster Bank      |                      |             | RBS Citizens (1) |                      |             | Wealth           |                      |             |
|-----------------------------------------------------|------------------|----------------------|-------------|------------------|----------------------|-------------|------------------|----------------------|-------------|------------------|----------------------|-------------|
|                                                     | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m |
| 2013                                                |                  |                      |             |                  |                      |             |                  |                      |             |                  |                      |             |
| <= 50%                                              | 26,392           | 313                  | 26,705      | 2,025            | 170                  | 2,195       | 4,669            | 98                   | 4,767       | 3,400            | 16                   | 3,416       |
| > 50% and <= 70%                                    | 34,699           | 591                  | 35,290      | 1,837            | 195                  | 2,032       | 5,529            | 89                   | 5,618       | 3,397            | 20                   | 3,417       |
| > 70% and <= 90%                                    | 28,920           | 854                  | 29,774      | 2,326            | 288                  | 2,614       | 5,553            | 110                  | 5,663       | 1,337            | 44                   | 1,381       |
| > 90% and <= 100%                                   | 4,057            | 315                  | 4,372       | 1,214            | 162                  | 1,376       | 1,309            | 39                   | 1,348       | 87               | 7                    | 94          |
| > 100% and <= 110%                                  | 1,790            | 182                  | 1,972       | 1,302            | 182                  | 1,484       | 752              | 22                   | 774         | 87               | 15                   | 102         |
| > 110% and <= 130%                                  | 552              | 100                  | 652         | 2,509            | 461                  | 2,970       | 637              | 17                   | 654         | 27               | 6                    | 33          |
| > 130% and <= 150%                                  | 37               | 5                    | 42          | 2,202            | 549                  | 2,751       | 183              | 5                    | 188         | 4                | 4                    | 8           |
| > 150%                                              | —                | —                    | —           | 2,385            | 1,227                | 3,612       | 102              | 4                    | 106         | 24               | 6                    | 30          |
| Total with LTVs                                     | 96,447           | 2,360                | 98,807      | 15,800           | 3,234                | 19,034      | 18,734           | 384                  | 19,118      | 8,363            | 118                  | 8,481       |
| Other (2)                                           | 511              | 20                   | 531         | —                | —                    | —           | 463              | 3                    | 466         | 215              | 5                    | 220         |
| Total                                               | 96,958           | 2,380                | 99,338      | 15,800           | 3,234                | 19,034      | 19,197           | 387                  | 19,584      | 8,578            | 123                  | 8,701       |
| Total portfolio average LTV (3)                     | 62%              | 75%                  | 62%         | 103%             | 130%                 | 108%        | 67%              | 69%                  | 67%         | 51%              | 77%                  | 51%         |
| Average LTV on new originations during the year (3) |                  |                      | 67%         |                  |                      | 73%         |                  |                      | 68%         |                  |                      | 52%         |
| 2012                                                |                  |                      |             |                  |                      |             |                  |                      |             |                  |                      |             |
| <= 50%                                              | 22,306           | 327                  | 22,633      | 2,182            | 274                  | 2,456       | 4,167            | 51                   | 4,218       | 3,905            | 9                    | 3,914       |
| > 50% and <= 70%                                    | 27,408           | 457                  | 27,865      | 1,635            | 197                  | 1,832       | 4,806            | 76                   | 4,882       | 2,790            | 12                   | 2,802       |
| > 70% and <= 90%                                    | 34,002           | 767                  | 34,769      | 2,019            | 294                  | 2,313       | 6,461            | 114                  | 6,575       | 1,080            | 27                   | 1,107       |
| > 90% and <= 100%                                   | 7,073            | 366                  | 7,439       | 1,119            | 156                  | 1,275       | 2,011            | 57                   | 2,068       | 93               | 7                    | 100         |
| > 100% and <= 110%                                  | 3,301            | 290                  | 3,591       | 1,239            | 174                  | 1,413       | 1,280            | 43                   | 1,323       | 69               | 13                   | 82          |
| > 110% and <= 130%                                  | 1,919            | 239                  | 2,158       | 2,412            | 397                  | 2,809       | 1,263            | 42                   | 1,305       | 49               | 7                    | 56          |
| > 130% and <= 150%                                  | 83               | 26                   | 109         | 2,144            | 474                  | 2,618       | 463              | 14                   | 477         | 16               | 3                    | 19          |
| > 150%                                              | —                | —                    | —           | 3,156            | 1,290                | 4,446       | 365              | 14                   | 379         | 29               | 3                    | 32          |
| Total with LTVs                                     | 96,092           | 2,472                | 98,564      | 15,906           | 3,256                | 19,162      | 20,816           | 411                  | 21,227      | 8,031            | 81                   | 8,112       |
| Other (2)                                           | 486              | 12                   | 498         | —                | —                    | —           | 292              | 19                   | 311         | 674              | —                    | 674         |
| Total                                               | 96,578           | 2,484                | 99,062      | 15,906           | 3,256                | 19,162      | 21,108           | 430                  | 21,538      | 8,705            | 81                   | 8,786       |
| Total portfolio average LTV (3)                     | 66%              | 80%                  | 67%         | 108%             | 132%                 | 112%        | 75%              | 86%                  | 75%         | 51%              | 78%                  | 51%         |
| Average LTV on new originations during the year (3) |                  |                      | 65%         |                  |                      | 74%         |                  |                      | 64%         |                  |                      |             |

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

## Financial review *Risk and balance sheet management*

|                                                     | UK Retail        |                          |             | Ulster Bank      |                          |             | RBS Citizens (1) |                          |             |
|-----------------------------------------------------|------------------|--------------------------|-------------|------------------|--------------------------|-------------|------------------|--------------------------|-------------|
|                                                     | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m |
| <i>Loan-to-value ratio</i>                          |                  |                          |             |                  |                          |             |                  |                          |             |
| 2011                                                |                  |                          |             |                  |                          |             |                  |                          |             |
| <= 50%                                              | 21,537           | 285                      | 21,822      | 2,568            | 222                      | 2,790       | 4,745            | 49                       | 4,794       |
| > 50% and <= 70%                                    | 25,598           | 390                      | 25,988      | 1,877            | 157                      | 2,034       | 4,713            | 78                       | 4,791       |
| > 70% and <= 90%                                    | 33,738           | 671                      | 34,409      | 2,280            | 223                      | 2,503       | 6,893            | 125                      | 7,018       |
| > 90% and <= 100%                                   | 7,365            | 343                      | 7,708       | 1,377            | 128                      | 1,505       | 2,352            | 66                       | 2,418       |
| > 100% and <= 110%                                  | 3,817            | 276                      | 4,093       | 1,462            | 130                      | 1,592       | 1,517            | 53                       | 1,570       |
| > 110% and <= 130%                                  | 1,514            | 199                      | 1,713       | 2,752            | 322                      | 3,074       | 1,536            | 53                       | 1,589       |
| > 130% and <= 150%                                  | 60               | 15                       | 75          | 2,607            | 369                      | 2,976       | 626              | 28                       | 654         |
| > 150%                                              | —                | —                        | —           | 2,798            | 748                      | 3,546       | 588              | 27                       | 615         |
| Total with LTVs                                     | 93,629           | 2,179                    | 95,808      | 17,721           | 2,299                    | 20,020      | 22,970           | 479                      | 23,449      |
| Other (2)                                           | 567              | 13                       | 580         | —                | —                        | —           | 681              | 23                       | 704         |
| Total                                               | 94,196           | 2,192                    | 96,388      | 17,721           | 2,299                    | 20,020      | 23,651           | 502                      | 24,153      |
| Total portfolio average LTV (3)                     | 67%              | 80%                      | 67%         | 104%             | 125%                     | 106%        | 76%              | 91%                      | 77%         |
| Average LTV on new originations during the year (3) |                  |                          | 63%         |                  |                          | 74%         |                  |                          | 63%         |

### Notes:

(1) Includes residential mortgages and home equity loans and lines (refer to page 88 for a breakdown of balances).

(2) Where no indexed LTV is held.

(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

### Counterparty credit risk

The RBS Group mitigates counterparty credit risk arising from both derivatives and repurchase agreements through the use of netting, collateral and the use of market standard documentation.

The RBS Group mitigates counterparty credit risk by netting amounts it owes to a counterparty against amounts the same counterparty owes to it, in accordance with relevant regulatory and internal policies. It generally does so only if it has a netting agreement in place as well as a legal opinion to the effect that the agreement is enforceable in the relevant jurisdictions.

Collateral generally takes the form of cash. In the case of repurchase agreements, collateral usually takes the form of debt and equity securities at the outset but if the value of collateral falls relative to that of the obligation, the Group may require additional collateral in the form of cash (variation margin). Industry standard documentation, such as master repurchase agreements and credit support annexes accompanied by legal opinion, is used for financial collateral taken as part of trading activities.

The RBS Group limits counterparty credit exposures by setting limits which take into account the potential adverse movement of a counterparty credit exposure after adjusting the impact of netting and collateral where applicable.

|                                                         | 2013<br>£bn | 2012<br>£bn | 2011<br>£bn |
|---------------------------------------------------------|-------------|-------------|-------------|
| <i>Mitigation of counterparty credit risk</i>           |             |             |             |
| Reverse repurchase agreements                           | 76.3        | 104.5       | 99.0        |
| Securities received as collateral (1)                   | (76.3)      | (104.4)     | (97.9)      |
| Derivative assets gross exposure                        |             |             |             |
| - balances with holding company and fellow subsidiaries | 3.4         | 7.2         | 10.4        |
| - balances with third parties                           | 286.0       | 437.9       | 522.4       |
| Counterparty netting                                    | (242.8)     | (373.8)     | (440.9)     |
| Cash collateral held                                    | (23.6)      | (33.4)      | (36.4)      |
| Securities received as collateral                       | (6.0)       | (5.6)       | (5.3)       |

### Note:

(1) In accordance with normal market practice, at 31 December 2013 £63.6 billion (2012 - £100.9 billion; 2011 - £95.9 billion) had been resold or re-pledged as collateral for the Group's own transactions.



## Financial review *Risk and balance sheet management*

### Credit risk continued

#### Early problem identification and problem debt management

##### Wholesale

##### Early problem identification

Each division has defined early warning indicators (EWIs) to identify customers experiencing financial difficulty, and to increase monitoring if needed. EWIs may be internal, such as a customer's bank account activity, or external, such as a publicly-listed customer's share price. If EWIs show a customer is experiencing potential or actual difficulty, divisional credit officers may decide to place it on the Watchlist.

##### Watchlist\*

There are three Watch classifications - Amber, Red and Black - reflecting progressively deteriorating conditions. Watch Amber customers are performing customers who show early signs of potential financial difficulty, or have other characteristics that warrant closer monitoring. Watch Red customers are performing customers who show signs of declining creditworthiness which requires active management usually by the Global Restructuring Group (GRG). Watch Black customers include risk elements in lending and potential problem loans.

Once on the Watchlist, customers are subject to heightened scrutiny. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist units in divisions or by GRG. In more material cases, a forum of experienced credit, portfolio management and remedial management specialists in the divisions or GRG may reassess the customer relationship strategy. In accordance with Group-wide policies, a number of mandatory actions are taken, including a review of the customer's credit grade and facility and security documentation.

Other appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt. Such circumstances include deteriorating trading performance, imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

For all Watch Red cases, the division is required to consult with GRG on whether the relationship should be transferred to GRG (for more information on GRG, refer to below). Watch Red customers that continue to be managed by the divisions tend to be those requiring subject matter expertise that is available in the divisions rather than in GRG.

At 31 December 2013, exposures to customers reported as Watchlist Red and managed in the divisions totalled £2.9 billion (2012 - £3.9 billion).

Remediation strategies available in the divisions include granting a customer various types of concessions. Any decision to approve a concession will be a function of the division's specific country and sector appetite, the key metrics of the customer, the market environment and the loan structure and security. For further information, refer to the Wholesale forbearance section below.

Other potential outcomes of the relationship review are to: take the customer off the Watchlist; offer additional lending and continue monitoring; transfer the relationship to GRG if appropriate; or exit the relationship altogether.

The following table shows a sector breakdown of credit risk assets (CRA) (lending and net derivatives) of Watch Red customers under GRG management:

|                                          | 2013         |                |               | 2012          |                |               | 2011          |                |               |
|------------------------------------------|--------------|----------------|---------------|---------------|----------------|---------------|---------------|----------------|---------------|
|                                          | Core<br>£m   | Non-Core<br>£m | Total<br>£m   | Core<br>£m    | Non-Core<br>£m | Total<br>£m   | Core<br>£m    | Non-Core<br>£m | Total<br>£m   |
| <i>Watch Red CRA by current exposure</i> |              |                |               |               |                |               |               |                |               |
| Property                                 | 3,176        | 1,841          | 5,017         | 5,605         | 4,373          | 9,978         | 6,213         | 5,994          | 12,207        |
| Transport                                | 1,778        | 376            | 2,154         | 2,212         | 331            | 2,543         | 1,041         | 2,195          | 3,236         |
| Retail and leisure                       | 1,085        | 237            | 1,322         | 1,481         | 412            | 1,893         | 1,501         | 620            | 2,121         |
| Services                                 | 955          | 39             | 994           | 869           | 82             | 951           | 711           | 117            | 828           |
| Other                                    | 2,304        | 646            | 2,950         | 3,066         | 1,099          | 4,165         | 1,703         | 811            | 2,514         |
| <b>Total</b>                             | <b>9,298</b> | <b>3,139</b>   | <b>12,437</b> | <b>13,233</b> | <b>6,297</b>   | <b>19,530</b> | <b>11,169</b> | <b>9,737</b>   | <b>20,906</b> |

The decrease in Watch Red cases was driven predominantly by a lower flow of cases into GRG, repayments and movement of cases into Watch Black. The overall value of customers in default has however reduced during the year. For further information regarding the asset quality of the Group's portfolio refer to the Asset quality section on page 115.

##### Global Restructuring Group

GRG manages the Group's wholesale problem debt portfolio in cases where its exposure to the customer exceeds £1 million. In addition, GRG provides a specialist credit function, the Strategy Management Unit, for distressed bilateral lending where the exposure is between £250,000 and £1 million. The primary function of GRG is to restore customers to an acceptable credit condition and minimise losses to the RBS Group.

The factor common to all customers managed by GRG is that the Group's exposure is outside risk appetite. Customers transferred to GRG typically show symptoms of significant financial difficulty, such as cash flow pressures, or show evidence that the management team has limited experience of managing a business in difficulty. In addition, a customer may be transferred to GRG if the Group is not provided with sufficient or reliable information on which to make decisions.

GRG relationship managers use their skill, experience and judgement to support customers through these difficulties while seeking to minimise losses to protect the Group's capital.

\*unaudited

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## Financial review *Risk and balance sheet management*

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When the relationship is transferred, GRG conducts a detailed assessment of the viability of the business as well as the ability of management to deal with the causes of financial difficulty. Following GRG's initial file assessment and, if appropriate, wider due diligence with input from independent experts (sector experts, accountants and surveyors), various options are presented to the customer. A strategy is then agreed with the customer for dealing with the distressed loan.

The objective is to find a mutually acceptable solution, including repayment, refinancing or transfer to another bank if that is the customer's preferred option. Once a solution is found, management of the loans may be transferred back to the performing divisions. If the business is not viable and a turnaround is not possible, insolvency may be an option.

### Wholesale forbearance

#### Definition

Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Concessions granted where there is no evidence of financial difficulty, or where any changes to terms and conditions are within the Group's usual risk appetite (for a customer new to the Group), or reflect improving credit market conditions for the customer, are not considered forbearance.

A number of options are available to the Group. Such actions are tailored to the customer's individual circumstances. The aim of such actions is to restore the customer to financial health and to minimise risk to the Group. To ensure that forbearance is appropriate for the needs and financial profile of the customer, the Group applies minimum standards when assessing, recording, monitoring and reporting forbearance.

#### Types of wholesale forbearance

Wholesale forbearance may involve the following types of concessions:

- Payment concessions and loan rescheduling, including extensions in contractual maturity, may be granted to improve the customer's liquidity. Concessions may also be granted on the expectation that the customer's liquidity will recover when market conditions improve. In addition, they may be granted if the customer will benefit from access to alternative sources of liquidity, such as an issue of equity capital. These options are commonly used in commercial real estate transactions, particularly where a shortage of market liquidity rules out immediate refinancing and makes short-term collateral sales unattractive.

- Debt may be forgiven, or exchanged for equity, where the customer's business or economic environment means that it cannot meet obligations and where other forms of forbearance are unlikely to succeed. Debt forgiveness is commonly used for stressed leveraged finance transactions. These are typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Provided that the underlying business model, strategy and debt level are viable, maintaining the business as a going concern is the preferred option, rather than realising the value of the underlying assets.

A temporary covenant waiver, a recalibration of covenants or a covenant amendment may be used to cure a potential or actual covenant breach. In return for this relief, the Group would seek to obtain a return commensurate with the risk that it is required to take. The increased return for the increased risk can be structured flexibly to take into account the customer's circumstances for example increased margin on a cash or payment in kind basis, and/or deferred return instruments.

The contractual margin may be amended to bolster the customer's day-to-day liquidity to help sustain the customer's business as a going concern. This would normally be a short-term solution. As set out above, the Group would seek to obtain a return commensurate to the risk that it is required to take and this can be structured in the same ways set out above.

Loans may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan's terms. All customers are assigned a PD and related facilities a LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms. Where forbearance is no longer viable, the Group will consider other options such as the enforcement of security and/or insolvency proceedings.

The ultimate outcome of a forbearance strategy is unknown at the time of execution. It is highly dependent on the cooperation of the borrower and the continued existence of a viable business. The following are generally considered to be options of last resort:

- Enforcement of security or otherwise taking control of assets - Where the RBS Group holds collateral or other security interest and is entitled to enforce its rights, it may enforce its security or otherwise take ownership or control of the assets. The RBS Group's preferred strategy is to consider other possible options prior to exercising these rights.
- Insolvency - Where there is no suitable forbearance 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.



## Financial review *Risk and balance sheet management*

### Credit risk continued

#### Early problem identification and problem debt management continued

The data presented in the tables below include loans forborne during 2011, 2012 and 2013 which individually exceeded thresholds set at divisional level. The Group continues to refine its reporting processes for forborne loans and, as a result, in 2013, thresholds were reduced to range from nil to £3 million. During 2011 and 2012, these thresholds ranged from nil to £10 million. The proportion of the Watch and GRG population covered by these thresholds has changed over time as the thresholds have been reduced. In 2013, this was 90% (2012 - 84%).

As part of the Group's ongoing review of forbearance reporting, the amounts shown as "Completed forbearance" relating to 2012 and 2013 now include loans granted covenant concessions only. These were disclosed by way of a note in 2012. While the RBS Group considers these types of concessions qualitatively different from other forms of forbearance, they constitute a significant proportion of wholesale forbearance and were therefore included.

The table below shows the value of loans (excluding loans where the Group has initiated recovery procedures) where forbearance was completed during the year, by sector and types.

| Wholesale forbearance during the year by sector | 2013             |                      |                                | 2012             |                      |                                | 2011             |                      |                                |
|-------------------------------------------------|------------------|----------------------|--------------------------------|------------------|----------------------|--------------------------------|------------------|----------------------|--------------------------------|
|                                                 | Performing<br>£m | Non-performing<br>£m | Provision<br>coverage (1)<br>% | Performing<br>£m | Non-performing<br>£m | Provision<br>coverage (1)<br>% | Performing<br>£m | Non-performing<br>£m | Provision<br>coverage (1)<br>% |
| Property                                        | 1,759            | 4,802                | 60                             | 3,365            | 3,899                | 16                             | 2,166            | 3,215                | 25                             |
| Transport                                       | 1,016            | 229                  | 34                             | 1,174            | 130                  | 23                             | 771              | 670                  | 10                             |
| Retail and leisure                              | 455              | 390                  | 37                             | 732              | 113                  | 34                             | 331              | 433                  | 10                             |
| Services                                        | 405              | 234                  | 77                             | 324              | 51                   | 30                             | 177              | 94                   | 3                              |
| Other                                           | 670              | 510                  | 27                             | 1,575            | 550                  | 40                             | 773              | 731                  | 47                             |
|                                                 | 4,305            | 6,165                | 55                             | 7,170            | 4,743                | 20                             | 4,218            | 5,143                | 25                             |

#### Forbearance arrangements

The table below analyses the incidence of the main types of wholesale forbearance arrangements by loan value.

| Wholesale forbearance during the year by arrangement type (2) | 2013<br>% | 2012<br>% | 2011<br>% |
|---------------------------------------------------------------|-----------|-----------|-----------|
| Payment concessions and loan rescheduling                     | 78        | 49        | 92        |
| Other (3)                                                     | 31        | 14        | 9         |
| Covenant-only concessions                                     | 16        | 30        | —         |
| Forgiveness of all or part of the outstanding debt            | 9         | 21        | 33        |
| Variation in margin                                           | 2         | 6         | 12        |

#### Notes:

- (1) Provision coverage reflects impairment provision as a percentage of non-performing loans.
- (2) The total exceeds 100% as an individual case can involve more than one type of arrangement.
- (3) The main types of 'other' concessions include formal 'standstill' agreements and release of security.

#### Key points

- A number of refinements have been made in 2013 to the reporting of wholesale forbearance as explained below:
  - Change in reporting thresholds from £10 million to £3 million, increased forbearance reported by £1.7 billion.
  - During ongoing portfolio reviews, a number of facilities totalling £2.3 billion were identified which were being managed in accordance with an agreed forbearance strategy but where the forbearance had not been formally documented. These have been included in the tables above, which has led to an increase in completed forbearance for 2013 and a corresponding decrease in loans which are "in process" for the purpose of forbearance (in process loans are explained below).
  - Covenant only forbearance of £1.7 billion (2012 - £3.5 billion) has been included.
- Year-on-year analysis of forborne loans may be skewed by individual material cases during a given year. This is particularly relevant when comparing the value of forbearance completed in the property and transport sectors in 2013 with previous years.
- At 31 December 2013, loans totalling £9.4 billion (2012 - £13.7 billion) were granted credit approval for forbearance but where such forbearance had not yet been formally documented and which were not being managed in accordance with an agreed forbearance strategy. These loans are referred to as in process and are not included in the tables above. 84% of these were non-performing loans, with an associated provision coverage of 44%, and 16% were performing loans. The principal types of arrangements offered included payment concessions and loan rescheduling, covenant concessions, forgiveness of all or part of the outstanding debt and variations in margin.

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## Financial review *Risk and balance sheet management*

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- Loans forborne during 2012 and 2013 and outstanding at 31 December 2013 totalled £18.4 billion, of which £8.0 billion related to arrangements completed during 2012.
- Core bank customers were granted forbearance by GRG on loan facilities totalling £6.9 billion during 2012 and 2013, which equates to 23% of loans managed by GRG (excluding loans to customers managed by recovery units). Of these loans, 15% by value had been returned to performing portfolios managed within the originating divisions by 31 December 2013. There are also loans that are not forborne which have been returned from GRG to performing portfolios managed within the originating divisions. 79% by value of the performing Core loans granted forbearance during 2012 remained performing as at 31 December 2013.\*
- Provision coverage for forborne loans increased during the year. This was primarily the result of provisions in Ulster Bank, specifically in the property sector, and driven by the Group's RCR strategy. For further information regarding Ulster Bank refer to the Ulster Bank Group (Core and Non-Core) section on pages 93 to 95.

### Retail Collections

Collections functions in each of the RBS Group's retail businesses provide support and assistance to customers who are experiencing difficulties in meeting their obligations to the Group. Such customers may miss a payment on their loan or borrow more than their agreed limit, or contact the Group themselves asking for help. Dedicated support teams are also in place to identify and help customers who have not yet missed a payment but may be facing financial difficulty.

The collections function may use a range of tools to initiate contact with the customer, establish the cause of their financial difficulty and support them where possible. In the process, they may consider granting the customer forbearance.

Additionally, in the UK and Ireland, support is provided to customers with unsecured loans who establish a repayment plan with the Group through a debt advice agency or a self-help tool. Such "breathing space" suspends collections activity for a 30-day period to allow time for the repayment plan to be put in place. Arrears continue to accrue for customer loans granted breathing space.

If collections strategies are unsuccessful the relationship is transferred to the recoveries team. For further details on recoveries, refer to page 78.

\*unaudited

### Retail forbearance

#### Definition

Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties. In UK Retail and Ulster Bank, a broader definition of forbearance is used that includes mortgages where a customer has made a change to contractual terms, when their payments status is up-to-date and they are not necessarily evidencing signs of financial difficulty. Forbearance is granted on a permanent, or temporary, basis following an assessment of the customer's individual circumstances and ability to pay. For UK Retail and Ulster Bank, the disclosure covers changes in contractual terms dating back to January 2008 and early 2009 respectively.

#### Identification

Customers who contact the bank directly because of financial difficulties, or who are already in payment arrears, may be granted forbearance. In the course of assisting customers, more than one forbearance treatment may be granted.

#### Types of retail forbearance

Forbearance is granted principally to customers with mortgages and less extensively to customers with unsecured loans.

#### Mortgage portfolios

Forbearance options include, but are not limited to, payment concessions, capitalisations of arrears, term extensions and temporary conversions to interest only.

- Payment concessions - A temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period. Ulster Bank and RBS Citizens also offer payment concessions in the form of discounted interest rates that involve the forgiveness of some interest (further details below).
- Capitalisation of arrears - The customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.
- Term extensions - The maturity date of the loan is extended.
- Interest only conversions - The loan converts from principal and interest repayment to interest only repayment on a temporary basis (Ulster Bank only).

In UK Retail, interest only conversions have not been used to support customers in financial difficulty since 2009, and from 2012 have only been permitted on a very exceptional basis for residential mortgage customers who are up to date on payments. As a result interest only loans with permanent changes to terms are historical stock. In Ulster Bank, interest only conversions are offered to customers under financial stress and solely on a temporary basis.

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## Financial review *Risk and balance sheet management*

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### **Credit risk: Early problem identification and problem debt management** continued

In response to the economic difficulties in the Republic of Ireland, Ulster Bank has developed additional forbearance options. These payment concessions support customers over an extended period of time and include instances where some interest is forgiven by granting interest rate discounts for a 3-5 year period.

Similarly RBS Citizens participates in the US government mandated Home Affordable Modification Program as well as its own proprietary programme. Both feature a combination of term extensions, capitalisations of arrears, interest rate reductions and conversions from interest only to amortising. These tend to be permanent changes to contractual terms. In order to qualify for either of the programmes, customers must meet government-specified or internal criteria designed to evidence financial difficulty but demonstrate a willingness to pay.

#### *Unsecured portfolios*

For unsecured portfolios in UK Retail and Ulster Bank, forbearance entails reduced or deferred payments. Arrangements to facilitate the repayment of overdraft excesses or loan arrears can be agreed dependent on affordability. Where repayment arrangements are not affordable debt consolidation loans can be provided to customers in collections.

In RBS Citizens, granting of forbearance is predominantly restricted to short-term (1-3 months) loan extensions to alleviate the financial burden caused by temporary hardship. Such extensions are offered only if a customer has demonstrated a capacity and willingness to pay. The number and frequency of extensions granted to a customer are limited. Additionally, for loans secured by vehicles and credit cards, RBS Citizens may offer temporary interest rate modifications, but no principal reductions. Forbearance may also be offered to student loan customers consistent with the policy guidelines of the US Office of the Comptroller of the Currency.

- For unsecured portfolios in UK Retail, £121 million of balances (1% of the total unsecured balances) were subject to forbearance at 2013 year end.
- For unsecured portfolios in Ulster Bank, £16 million (3.8% by value) of the population was subject to forbearance at 31 December 2013.
- For unsecured portfolios in RBS Citizens, £135 million (1.7% of the unsecured balances) were subject to forbearance at 2013 year end (includes auto and recreational vehicle marine portfolios and excludes small business loans as these are included as part of wholesale reporting).

#### *Monitoring of forbearance*

Forbearance loans may be performing or non-performing. The granting of forbearance does not change the delinquency status of the loan unless the arrangement involves a capitalisation of all existing arrears of principal and interest, in which case the loan becomes up-to-date.

Loans granted forbearance are included in the non-performing book: when 90 days past due; or if the forbearance arrangement is a payment concession that involves a reduction in contractually required cash flows i.e. the forgiveness of interest. Such loans are classified as impaired. In RBS Citizens, all loans subject to forbearance are included in the non-performing book.

There are instances when loans subject to forbearance are transferred from the non-performing book to the performing book. In UK Retail, when arrears are capitalised, a loan is transferred to the performing book once the borrower has met the revised payment terms for at least six months and is expected to continue to do so. In addition, a small portfolio of loans past due 90 days are managed by UK Retail's collections function. Loans in this portfolio may also be transferred to the performing book if the customer makes payments that reduce arrears below 90 days.

In Ulster Bank, if a customer makes payments that reduce loan arrears below 90 days, the loan is transferred to the performing book. In addition, where a customer meets the original payment terms for six months and is expected to continue to do so, capitalisation may be agreed. In these cases the loan is also transferred to the performing book.

Mortgages granted forbearance are reviewed regularly to ensure that customers are meeting the agreed terms. Key metrics have been developed to record the proportion of loans that fail to meet the agreed terms over time, as well as the proportion of loans that return to performing with no arrears. Retail forbearance loans can be modified more than once.

Twelve month default rates are calculated for all mortgage forbearance types. In 2013, the average twelve month default rates were 8% for UK Retail, 18% for Ulster Bank and 13% for RBS Citizens.

## Financial review *Risk and balance sheet management*

### Arrears status and provisions

The mortgage arrears information for retail accounts in forbearance and related provision are shown in the tables below.

|                   | No missed payments |                 | 1-3 months in arrears |                 | >3 months in arrears |                 |               |                 | Total                         |
|-------------------|--------------------|-----------------|-----------------------|-----------------|----------------------|-----------------|---------------|-----------------|-------------------------------|
|                   | Balance<br>£m      | Provision<br>£m | Balance<br>£m         | Provision<br>£m | Balance<br>£m        | Provision<br>£m | Balance<br>£m | Provision<br>£m | Forborne<br>balances (1)<br>% |
| <b>2013</b>       |                    |                 |                       |                 |                      |                 |               |                 |                               |
| UK Retail (2,3)   | 4,596              | 17              | 426                   | 23              | 424                  | 51              | 5,446         | 91              | 5.5                           |
| Ulster Bank (2,3) | 1,362              | 166             | 631                   | 76              | 789                  | 323             | 2,782         | 565             | 14.6                          |
| RBS Citizens      | 287                | 26              | 33                    | 3               | 53                   | —               | 373           | 29              | 1.9                           |
| Wealth            | 112                | 3               | 6                     | —               | 9                    | —               | 127           | 3               | 1.5                           |
|                   | <b>6,357</b>       | <b>212</b>      | <b>1,096</b>          | <b>102</b>      | <b>1,275</b>         | <b>374</b>      | <b>8,728</b>  | <b>688</b>      | <b>6.0</b>                    |
| <b>2012</b>       |                    |                 |                       |                 |                      |                 |               |                 |                               |
| UK Retail (2,3)   | 4,006              | 20              | 388                   | 16              | 450                  | 64              | 4,844         | 100             | 4.9                           |
| Ulster Bank (2,3) | 915                | 100             | 546                   | 60              | 527                  | 194             | 1,988         | 354             | 10.4                          |
| RBS Citizens      | —                  | —               | 179                   | 25              | 160                  | 10              | 339           | 35              | 1.6                           |
| Wealth            | 38                 | —               | —                     | —               | 7                    | —               | 45            | —               | 0.5                           |
|                   | <b>4,959</b>       | <b>120</b>      | <b>1,113</b>          | <b>101</b>      | <b>1,144</b>         | <b>268</b>      | <b>7,216</b>  | <b>489</b>      | <b>4.9</b>                    |
| <b>2011</b>       |                    |                 |                       |                 |                      |                 |               |                 |                               |
| UK Retail (2,3)   | 3,677              | 16              | 351                   | 13              | 407                  | 59              | 4,435         | 88              | 4.7                           |
| Ulster Bank (2,3) | 893                | 78              | 516                   | 45              | 421                  | 124             | 1,830         | 247             | 9.1                           |
| RBS Citizens      | —                  | —               | 91                    | 10              | 89                   | 10              | 180           | 20              | 0.8                           |
| Wealth            | 121                | —               | —                     | —               | 2                    | —               | 123           | —               | 1.3                           |
|                   | <b>4,691</b>       | <b>94</b>       | <b>958</b>            | <b>68</b>       | <b>919</b>           | <b>193</b>      | <b>6,568</b>  | <b>355</b>      | <b>4.4</b>                    |

#### Notes:

- (1) As a percentage of mortgage loans.
- (2) Forbearance in UK Retail and Ulster Bank capture all instances where a change has been made to the contractual payment terms including those where the customer is up-to-date on payments and there is no obvious evidence of financial difficulty.
- (3) Includes the current stock position of forbearance deals agreed since early 2008 for UK Retail and early 2009 for Ulster Bank.

## Financial review *Risk and balance sheet management*

### Credit risk: Early problem identification and problem debt management continued

#### Forbearance arrangements

The incidence of the main types of retail forbearance on the balance sheet are analysed below.

|                                                         | UK Retail<br>£m | Ulster Bank<br>£m | RBS Citizens<br>£m | Wealth<br>£m | Total (1)<br>£m |
|---------------------------------------------------------|-----------------|-------------------|--------------------|--------------|-----------------|
| <b>2013</b>                                             |                 |                   |                    |              |                 |
| Interest only conversions - temporary and permanent (2) | 1,784           | 512               | —                  | —            | 2,296           |
| Term extensions - capital repayment and interest only   | 2,478           | 325               | 35                 | 29           | 2,867           |
| Payment concessions (3)                                 | 241             | 1,567             | 246                | 12           | 2,066           |
| Capitalisation of arrears                               | 907             | 494               | —                  | —            | 1,401           |
| Other                                                   | 366             | —                 | 92                 | 86           | 544             |
|                                                         | <b>5,776</b>    | <b>2,898</b>      | <b>373</b>         | <b>127</b>   | <b>9,174</b>    |
| <b>2012</b>                                             |                 |                   |                    |              |                 |
| Interest only conversions - temporary and permanent     | 1,220           | 924               | —                  | 6            | 2,150           |
| Term extensions - capital repayment and interest only   | 2,271           | 183               | —                  | 27           | 2,481           |
| Payment concessions (3)                                 | 215             | 762               | 339                | 9            | 1,325           |
| Capitalisation of arrears                               | 932             | 119               | —                  | —            | 1,051           |
| Other                                                   | 452             | —                 | —                  | 3            | 455             |
|                                                         | <b>5,090</b>    | <b>1,988</b>      | <b>339</b>         | <b>45</b>    | <b>7,462</b>    |
| <b>2011</b>                                             |                 |                   |                    |              |                 |
| Interest only conversions - temporary and permanent     | 1,269           | 795               | —                  | 3            | 2,067           |
| Term extensions - capital repayment and interest only   | 1,805           | 58                | —                  | 97           | 1,960           |
| Payment concessions                                     | 198             | 876               | 180                | —            | 1,254           |
| Capitalisation of arrears                               | 864             | 101               | —                  | —            | 965             |
| Other                                                   | 517             | —                 | —                  | 23           | 540             |
|                                                         | <b>4,653</b>    | <b>1,830</b>      | <b>180</b>         | <b>123</b>   | <b>6,786</b>    |

#### Notes:

- (1) As an individual case can include more than one type of arrangement, the analysis in the table on forbearance arrangements exceeds the total value of cases subject to forbearance.
- (2) The year-on-year increase for UK Retail was driven by an extension of the reporting definition to include legacy conversions to interest only repayment in cases where customers were previously on a combination of repayment types.
- (3) Includes £365 million of Ulster Bank loans (2012 - £10 million) and £62 million of RBS Citizens loans (2012 - £31 million) where an interest rate discount has been agreed resulting in a reduction of contractual cash flows through forgiveness of interest.

The table below shows forbearance agreed during the year analysed between performing and non-performing.

|                            | UK Retail<br>£m | Ulster Bank<br>£m | RBS Citizens<br>£m | Wealth<br>£m | Total (1)<br>£m |
|----------------------------|-----------------|-------------------|--------------------|--------------|-----------------|
| <b>2013</b>                |                 |                   |                    |              |                 |
| Performing forbearance     | 1,332           | 2,223             | —                  | 41           | 3,596           |
| Non-performing forbearance | 186             | 1,213             | 101                | 22           | 1,522           |
| Total forbearance (1,2)    | <b>1,518</b>    | <b>3,436</b>      | <b>101</b>         | <b>63</b>    | <b>5,118</b>    |
| <b>2012</b>                |                 |                   |                    |              |                 |
| Performing forbearance     | 1,809           | 2,111             | 88                 | 18           | 4,026           |
| Non-performing forbearance | 184             | 1,009             | 71                 | 2            | 1,266           |
| Total forbearance (1,2)    | <b>1,993</b>    | <b>3,120</b>      | <b>159</b>         | <b>20</b>    | <b>5,292</b>    |

#### Notes:

- (1) An individual case can include more than one type of arrangement.
- (2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at year end. Balances are at year end.

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## Financial review *Risk and balance sheet management*

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### Key points

#### UK Retail

- At 31 December 2013, forbearance balances where the forbearance treatment was provided in the last 24 months amounted to £2 billion. This represented a 14% reduction in the year.
- The flow of new forbearance of £380 million in the fourth quarter of 2013 continued on a downward trend compared with an average of £456 million in the preceding four quarters. The full year flow for 2013 was £1.7 billion, a 15% reduction on the 2012 flow.
- 5.5% of total mortgage assets (£5.4 billion) were subject to a forbearance arrangement agreed since January 2008. This represented an increase from 4.9% on 2012 (£4.8 billion). The rise was driven by an extension of the reporting definition to include legacy conversions to interest only repayment in cases where customers were previously on a combination of repayment types. Excluding this change in definition, forbearance stock remained stable.
- Approximately 84% of forbearance loans (2012 - 83%) were up to date with payments compared with approximately 97% of assets not subject to forbearance activity.
- The majority (90%) of UK Retail forbearance is permanent in nature (term extensions, capitalisation of arrears, historic conversions to interest only). Temporary forbearance comprises payment concessions such as reduced or deferred payments with such arrangements typically agreed for a period of three to six months.
- The most frequently occurring forbearance types were term extensions (43% of forbearance loans at 31 December 2013), interest only conversions (31%) and capitalisations of arrears (16%). The growth of interest only stock reflected the extended definition referred to above. The underlying level of transfers was negligible and the remaining stock was the result of legacy policy. Conversions to interest only have only been permitted on a very exceptional basis since the fourth quarter of 2012 and have not been permitted for customers in financial difficulty since 2009.
- The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance.

#### Ulster Bank

- At 31 December 2013, 14.6% of total mortgage assets (£2.8 billion) were subject to a forbearance arrangement (agreed since early 2009), an increase from 10.4% (£2.0 billion) at 31 December 2012. This reflected Ulster Bank's proactive strategies to contact customers in financial difficulty to offer assistance.
- Although the forbearance stock increased by 40% during the year, the number of customers approaching Ulster Bank for assistance for the first time remained broadly stable. This can be attributed to more mortgages being put on to longer-term arrangements, and therefore not exiting forbearance.
- The majority of forbearance arrangements were less than 90 days in arrears (72%).
- The mix of forbearance treatments in Ulster Bank changed with an increase in longer-term solutions. A total of 28% of forbearance loans were subject to a permanent arrangement at 31 December 2013 (2012 - 15%). Capitalisations represented 17% and term extensions represented 11% of the forbearance portfolio at 31 December 2013, increasing from 6% and 9% respectively.
- The remaining forbearance loans were temporary concessions accounting for 72%. Short to medium-term concessions are offered for periods of three months to five years and incorporate different levels of repayment based on the customer's ability to pay.
- Temporary interest only arrangements decreased during 2013 to 18% of forbearance loans at 31 December 2013 (2012 - 46%). This reflected Ulster Bank's strategy to transition customers in financial difficulty to long-term arrangements.
- Payment concessions represented the remaining 54%, comprising: deals where payments amortised the outstanding balance (41%); a diminishing portfolio of deals that negatively amortised (10%); and payment holidays (3%).
- The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance.

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## Financial review *Risk and balance sheet management*

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### Credit risk: Early problem identification and problem debt management continued

#### Recoveries

Once a loan has been identified as impaired it is managed by divisional recoveries functions. Their goal is to collect the total outstanding and reduce the Group's loss by maximising cash recovery while treating customers fairly. Where an acceptable repayment arrangement cannot be agreed with the customer, litigation may be considered. In UK Retail and Northern Ireland, no repossession procedures are initiated until at least six months following the emergence of arrears. In the Republic of Ireland, new regulations prohibit taking legal action for an extended period. Additionally, certain forbearance options are made available to customers managed by the recoveries function.

#### Group impairment loss provisioning

##### Impaired definition

A financial asset is impaired if there is objective evidence that an event or events since initial recognition of the asset, has adversely affected the amount or timing of future cash flows from it. The loss is measured as the difference between the carrying value of the loan and the present value of estimated future cash flows discounted at the loan's original effective interest rate.

For both wholesale and retail exposures, days-past-due measures are typically used to identify evidence of impairment. In both corporate and retail portfolios, a period of 90 days past due is used. In sovereign portfolios, the period used is 180 days past due. Other factors are considered including: the borrower's financial condition; a forbearance event; a loan restructuring; the probability of bankruptcy; or any evidence of diminished cash flows.

#### Provisioning methodology

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. The current net realisable value of the collateral will be taken into account in determining the need for a provision. No impairment provision is recognised in cases where amounts due are expected to be settled in full on realisation of the security. The Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

#### Individually assessed provisions

Loans and securities above a defined threshold deemed to be individually significant are assessed on a case-by-case basis. Assessments of future cash flows take into account the impact of any guarantees or collateral held. Projections of cash flow receipts are based on the Group's judgement and facts available at the time. Projected cash flows are reviewed on subsequent assessment dates as new information becomes available.

#### Collectively assessed provisions

Provisions on impaired credits below an agreed threshold are assessed on a portfolio basis, reflecting the homogeneous nature of the assets. The RBS Group segments wholesale and retail portfolios according to product type, such as credit cards, personal loans and mortgages. The approach taken to assess impaired assets in collections differs from the approach taken to assess those in recoveries (refer to page 73 for further details on collections and refer to above for recoveries).

Provisions are determined based on a quantitative review of the relevant portfolio. They take account of the level of arrears, the value of any security, and historical and projected cash recovery trends over the recovery period. The provisions also incorporate any adjustments that may be deemed appropriate given current economic conditions. Such adjustments may be determined based on a review of the latest cash collections profile and operational processes used in managing exposures.

#### Latent loss provisions

In the performing portfolio, latent loss provisions are held against losses incurred but not identified before the balance sheet date. Latent loss provisions reflect PDs and LGDs as well as emergence periods. The emergence period is defined as the period between the occurrence of the impairment event and a loan being identified and reported as impaired.

Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as coupon period and repayment terms, and the duration of the administrative process required to report and identify an impaired loan as such. Emergence periods vary across different portfolios from 2 to 225 days. They are based on actual experience within the particular portfolio and are reviewed regularly.

The RBS Group's retail businesses segment their performing loan books into homogeneous portfolios such as mortgages, credit cards or unsecured loans, to reflect their different credit characteristics. Latent provisions are computed by applying portfolio level LGDs, PDs and emergence periods. The wholesale calculation is based on similar principles but there is no segmentation into portfolios. PDs and LGDs are calculated on an individual basis.

Refer to pages 140 to 156 for analysis of impaired loans, related provisions and impairments.



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## Financial review *Risk and balance sheet management*

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### Impact of forbearance on provisioning

#### Wholesale

Forbearance may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows. This may result in the recognition of an impairment loss or a write-off.

Provisions for forborne wholesale loans are assessed in accordance with the RBS Group's normal provisioning policies (refer to Group impairment loss provisioning on page 78). The customer's financial position and prospects as well as the likely effect of the forbearance, including any concessions granted, are considered in order to establish whether an impairment provision is required. Individual impairment assessments for wholesale loans are reassessed in the light of any revisions to the loan's terms.

All wholesale customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms and any revised grading incorporated in the calculation of the impairment loss provisions for the Group's wholesale exposures.

For performing counterparties, credit metrics are an integral part of the latent provision methodology and therefore the impact of covenant concessions will be reflected in the latent provision. For non-performing loans, covenant concessions will be considered in the overall provision adequacy for these loans.

In the case of non-performing loans that are forborne, the loan impairment provision assessment almost invariably takes place prior to forbearance being granted. The quantum of the loan impairment provision may change once the terms of the forbearance are known, resulting in an additional provision charge or a release of the provision in the period the forbearance is granted.

The transfer of wholesale loans subject to forbearance from impaired to performing status follows assessment by relationship managers in GRG. When no further losses are anticipated and the customer is expected to meet the loan's revised terms, any provision is written-off and the balance of the loan returned to performing status.

#### Retail

Provisions are assessed in accordance with the Group's provisioning policies (refer to Group impairment loss provisioning on page 78).

Impairment provisions in respect of loans subject to forbearance are evaluated as follows:

In UK Retail performing loans are subject to a latent loss provision but form a separate risk pool for 24 months. The higher of the observed default rates and PDs are used in the latent provisioning calculations for these loans to ensure that appropriate provision is held. Furthermore, for these portfolios the latent provision incorporates extended emergence periods. Once such loans are no longer separately identified, the use of account level PDs refreshed monthly in the latent provision methodology captures the underlying credit risk without a material time lag. There is no reassessment of the PD at the time forbearance is granted but the loan will be the subject to the latent provisioning methodology described above. Non-performing loans are subject to a collectively assessed provision methodology.

In Ulster Bank performing loans are subject to a latent loss provision but form a separate risk pool for the period of forbearance. The performance of forbearance arrangements is analysed and breakage (a single missed payment) rates computed. The higher of the breakage rate and the modelled PD for this separate risk pool is used when calculating the latent provision. Furthermore, for this portfolio the latent provision incorporates an extended emergence period. Once such loans are no longer separately identified, the use of account level PDs refreshed monthly in the latent provision methodology captures the underlying credit risk without a material time lag. There is no reassessment of the PD at the time forbearance is granted but the loan will be the subject to the latent provisioning methodology described above. Non-performing loans are subject to a collectively assessed provision methodology. However, loans not 90 days past due that are subject to forbearance arrangements involving a reduction in contractually required cash flows i.e. the forgiveness of interest and where arrears have not been capitalised are classified as non-performing. They form a separate risk pool for the period of forbearance and the related loan loss provision is computed using Ulster Bank's latent loss provision methodology.

Non-performing loans are grouped into homogeneous portfolios sharing similar credit characteristics according to the asset type. Further characteristics such as LTVs, arrears status and default vintage are also considered when assessing recoverable amount and calculating the related provision requirement. While non-performing forbearance retail loans do not form a separate risk pool, the LGD models used to calculate the collective impairment provision are affected by agreements made under forbearance arrangements.

In RBS Citizens, retail loans subject to forbearance are segmented from the rest of the non-forborne population and assessed individually for impairment loss throughout their lives until the loans are repaid or fully written off. The amount of recorded impairment depends on whether the loan is collateral dependent. If the loans are considered collateral dependent, the excess of the loan's carrying amount over the fair value of the collateral is the impairment amount. If the loan is not deemed collateral dependent, the excess of the loans' carrying amount over the present value of expected future cash flows is the impairment amount. Any confirmed losses are charged off immediately.

#### Write-offs

The Group normally writes-off loans when it has exhausted all its collection strategies and has no realistic chance of recovering the money it is owed. Refer to page 213 for further information on the Group's write-off policies and practices.



## Financial review *Risk and balance sheet management*

### Credit risk continued

#### Key loan portfolios\*

##### Commercial real estate

The commercial real estate sector comprised exposures to entities involved in the development of, or investment in, commercial and residential properties (including house builders). The analysis of lending utilisations below is gross of impairment provisions and excludes rate risk management and contingent obligations.

| Commercial real estate<br>by division (1) | 2013             |                   |             | 2012             |                   |             | 2011             |                   |             |
|-------------------------------------------|------------------|-------------------|-------------|------------------|-------------------|-------------|------------------|-------------------|-------------|
|                                           | Investment<br>£m | Development<br>£m | Total<br>£m | Investment<br>£m | Development<br>£m | Total<br>£m | Investment<br>£m | Development<br>£m | Total<br>£m |
| <b>Core</b>                               |                  |                   |             |                  |                   |             |                  |                   |             |
| UK Corporate                              | 20,547           | 3,467             | 24,014      | 22,504           | 4,091             | 26,595      | 25,101           | 5,023             | 30,124      |
| Ulster Bank                               | 3,419            | 718               | 4,137       | 3,575            | 729               | 4,304       | 3,882            | 881               | 4,763       |
| US Retail & Commercial                    | 4,018            | —                 | 4,018       | 3,857            | 3                 | 3,860       | 4,235            | 70                | 4,305       |
| International Banking                     | 762              | 182               | 944         | 849              | 315               | 1,164       | 872              | 299               | 1,171       |
| Markets                                   | 136              | 1                 | 137         | 630              | 57                | 687         | 141              | 61                | 202         |
|                                           | 28,882           | 4,368             | 33,250      | 31,415           | 5,195             | 36,610      | 34,231           | 6,334             | 40,565      |

##### Non-Core

|                        |        |        |        |        |        |        |        |        |        |
|------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| UK Corporate           | 1,201  | 774    | 1,975  | 2,651  | 983    | 3,634  | 3,957  | 2,020  | 5,977  |
| Ulster Bank            | 3,211  | 6,915  | 10,126 | 3,383  | 7,607  | 10,990 | 3,860  | 8,490  | 12,350 |
| US Retail & Commercial | 232    | —      | 232    | 392    | —      | 392    | 901    | 28     | 929    |
| International Banking  | 6,980  | 15     | 6,995  | 11,260 | 154    | 11,414 | 14,689 | 336    | 15,025 |
|                        | 11,624 | 7,704  | 19,328 | 17,686 | 8,744  | 26,430 | 23,407 | 10,874 | 34,281 |
|                        | 40,506 | 12,072 | 52,578 | 49,101 | 13,939 | 63,040 | 57,638 | 17,208 | 74,846 |

| Commercial real estate<br>by geography (1) | Investment       |                   | Development      |                   | Total<br>£m | Investment |                | Development |                | Total<br>£m |
|--------------------------------------------|------------------|-------------------|------------------|-------------------|-------------|------------|----------------|-------------|----------------|-------------|
|                                            | Commercial<br>£m | Residential<br>£m | Commercial<br>£m | Residential<br>£m |             | Core<br>£m | Non-Core<br>£m | Core<br>£m  | Non-Core<br>£m |             |
| <b>2013</b>                                |                  |                   |                  |                   |             |            |                |             |                |             |
| UK (excluding NI (2))                      | 20,862           | 5,007             | 678              | 3,733             | 30,280      | 21,297     | 4,572          | 3,500       | 911            | 30,280      |
| Ireland (ROI and NI (2))                   | 4,405            | 1,028             | 1,919            | 5,532             | 12,884      | 2,763      | 2,670          | 686         | 6,765          | 12,884      |
| Western Europe (other)                     | 4,068            | 183               | 22               | 17                | 4,290       | 223        | 4,028          | 11          | 28             | 4,290       |
| US                                         | 3,563            | 1,076             | —                | 8                 | 4,647       | 4,313      | 326            | 8           | —              | 4,647       |
| RoW (2)                                    | 314              | —                 | 30               | 133               | 477         | 286        | 28             | 163         | —              | 477         |
|                                            | 33,212           | 7,294             | 2,649            | 9,423             | 52,578      | 28,882     | 11,624         | 4,368       | 7,704          | 52,578      |

|                          |        |       |       |        |        |        |        |       |       |        |
|--------------------------|--------|-------|-------|--------|--------|--------|--------|-------|-------|--------|
| <b>2012</b>              |        |       |       |        |        |        |        |       |       |        |
| UK (excluding NI (2))    | 25,864 | 5,567 | 839   | 4,777  | 37,047 | 23,312 | 8,119  | 4,184 | 1,432 | 37,047 |
| Ireland (ROI and NI (2)) | 4,651  | 989   | 2,234 | 5,712  | 13,586 | 2,877  | 2,763  | 665   | 7,281 | 13,586 |
| Western Europe (other)   | 5,995  | 370   | 22    | 33     | 6,420  | 403    | 5,962  | 24    | 31    | 6,420  |
| US                       | 4,230  | 981   | —     | 15     | 5,226  | 4,629  | 582    | 15    | —     | 5,226  |
| RoW (2)                  | 454    | —     | 65    | 242    | 761    | 194    | 260    | 307   | —     | 761    |
|                          | 41,194 | 7,907 | 3,160 | 10,779 | 63,040 | 31,415 | 17,686 | 5,195 | 8,744 | 63,040 |

|                          |        |       |       |        |        |        |        |       |        |        |
|--------------------------|--------|-------|-------|--------|--------|--------|--------|-------|--------|--------|
| <b>2011</b>              |        |       |       |        |        |        |        |       |        |        |
| UK (excluding NI (2))    | 28,653 | 6,359 | 1,198 | 6,511  | 42,721 | 25,904 | 9,108  | 5,118 | 2,591  | 42,721 |
| Ireland (ROI and NI (2)) | 5,146  | 1,132 | 2,591 | 6,317  | 15,186 | 3,157  | 3,121  | 793   | 8,115  | 15,186 |
| Western Europe (other)   | 7,649  | 1,048 | 9     | 52     | 8,758  | 422    | 8,275  | 20    | 41     | 8,758  |
| US                       | 5,552  | 1,279 | 59    | 46     | 6,936  | 4,521  | 2,310  | 71    | 34     | 6,936  |
| RoW (2)                  | 785    | 35    | 141   | 284    | 1,245  | 227    | 593    | 332   | 93     | 1,245  |
|                          | 47,785 | 9,853 | 3,998 | 13,210 | 74,846 | 34,231 | 23,407 | 6,334 | 10,874 | 74,846 |

For the notes to these tables refer to the following page.

\*unaudited

## Financial review *Risk and balance sheet management*

| Commercial real estate by sub-sector (1) | UK<br>(excl NI (2))<br>£m | Ireland<br>(ROI and NI (2))<br>£m | Western Europe<br>£m | US<br>£m     | RoW (2)<br>£m | Total<br>£m   |
|------------------------------------------|---------------------------|-----------------------------------|----------------------|--------------|---------------|---------------|
| <b>2013</b>                              |                           |                                   |                      |              |               |               |
| Residential                              | 8,740                     | 6,560                             | 200                  | 1,085        | 133           | 16,718        |
| Office                                   | 4,557                     | 813                               | 1,439                | 32           | 121           | 6,962         |
| Retail                                   | 6,979                     | 1,501                             | 967                  | 84           | 73            | 9,604         |
| Industrial                               | 3,078                     | 454                               | 43                   | 30           | 13            | 3,618         |
| Mixed/other                              | 6,926                     | 3,556                             | 1,641                | 3,416        | 137           | 15,676        |
|                                          | <b>30,280</b>             | <b>12,884</b>                     | <b>4,290</b>         | <b>4,647</b> | <b>477</b>    | <b>52,578</b> |
| <b>2012</b>                              |                           |                                   |                      |              |               |               |
| Residential                              | 10,344                    | 6,701                             | 403                  | 996          | 242           | 18,686        |
| Office                                   | 6,112                     | 1,132                             | 1,851                | 99           | 176           | 9,370         |
| Retail                                   | 7,529                     | 1,492                             | 1,450                | 117          | 129           | 10,717        |
| Industrial                               | 3,550                     | 476                               | 143                  | 4            | 39            | 4,212         |
| Mixed/other                              | 9,512                     | 3,785                             | 2,573                | 4,010        | 175           | 20,055        |
|                                          | <b>37,047</b>             | <b>13,586</b>                     | <b>6,420</b>         | <b>5,226</b> | <b>761</b>    | <b>63,040</b> |
| <b>2011</b>                              |                           |                                   |                      |              |               |               |
| Residential                              | 12,870                    | 7,449                             | 1,100                | 1,325        | 319           | 23,063        |
| Office                                   | 7,155                     | 1,354                             | 2,246                | 404          | 352           | 11,511        |
| Retail                                   | 8,709                     | 1,641                             | 1,891                | 285          | 275           | 12,801        |
| Industrial                               | 4,317                     | 507                               | 520                  | 24           | 105           | 5,473         |
| Mixed/other                              | 9,670                     | 4,235                             | 3,001                | 4,898        | 194           | 21,998        |
|                                          | <b>42,721</b>             | <b>15,186</b>                     | <b>8,758</b>         | <b>6,936</b> | <b>1,245</b>  | <b>74,846</b> |

### Notes:

(1) Excludes commercial real estate lending in Wealth as these loans are generally supported by personal guarantees in addition to collateral. This portfolio, which totalled £1.4 billion at 31 December 2013 (2012 - £1.4 billion; 2011 - £1.3 billion) continued to perform in line with expectations and required minimal provision.

(2) ROI: Republic of Ireland; NI: Northern Ireland; RoW: Rest of World.

### Key points

- In line with RBS Group strategy, the overall gross lending exposure to commercial real estate (CRE) fell by £10.5 billion, or 17%, during 2013 to £52.6 billion. Gross lending exposure is now almost half of the exposure of four years ago. The overall mix of geography, sub-sector and investment and development remained broadly unchanged.
- A significant proportion of the decrease was in Non-Core and was due to repayments, asset sales and write-offs. The Non-Core portfolio totalled £19.3 billion (37% of the portfolio) at 31 December 2013 (2012 - £26.4 billion or 42% of the portfolio).
- The UK portfolio was focused on London and South East England. Approximately 47% of the portfolio was held in these areas at 31 December 2013 (2012 - 43%).

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk: Key loan portfolios\* continued

| Commercial real estate maturity profile of portfolio | UK Corporate<br>£m | Ulster Bank<br>£m | US Retail &<br>Commercial<br>£m | International<br>Banking<br>£m | Markets<br>£m | Total<br>£m   |
|------------------------------------------------------|--------------------|-------------------|---------------------------------|--------------------------------|---------------|---------------|
| <b>2013</b>                                          |                    |                   |                                 |                                |               |               |
| <i>Core</i>                                          |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 6,816              | 2,740             | 602                             | 352                            | 117           | 10,627        |
| 1-2 years                                            | 3,436              | 360               | 669                             | 203                            | —             | 4,668         |
| 2-3 years                                            | 4,721              | 177               | 739                             | 116                            | 7             | 5,760         |
| > 3 years                                            | 8,621              | 860               | 2,008                           | 273                            | 13            | 11,775        |
| Not classified (2)                                   | 420                | —                 | —                               | —                              | —             | 420           |
|                                                      | <b>24,014</b>      | <b>4,137</b>      | <b>4,018</b>                    | <b>944</b>                     | <b>137</b>    | <b>33,250</b> |
| <i>Non-Core</i>                                      |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 1,432              | 8,479             | 85                              | 4,864                          | —             | 14,860        |
| 1-2 years                                            | 77                 | 1,276             | 31                              | 507                            | —             | 1,891         |
| 2-3 years                                            | 36                 | 185               | 33                              | 220                            | —             | 474           |
| > 3 years                                            | 295                | 186               | 83                              | 1,404                          | —             | 1,968         |
| Not classified (2)                                   | 135                | —                 | —                               | —                              | —             | 135           |
|                                                      | <b>1,975</b>       | <b>10,126</b>     | <b>232</b>                      | <b>6,995</b>                   | <b>—</b>      | <b>19,328</b> |
| <b>2012</b>                                          |                    |                   |                                 |                                |               |               |
| <i>Core</i>                                          |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 8,639              | 3,000             | 797                             | 216                            | 59            | 12,711        |
| 1-2 years                                            | 3,999              | 284               | 801                             | 283                            | 130           | 5,497         |
| 2-3 years                                            | 3,817              | 215               | 667                             | 505                            | —             | 5,204         |
| > 3 years                                            | 9,597              | 805               | 1,595                           | 160                            | 498           | 12,655        |
| Not classified (2)                                   | 543                | —                 | —                               | —                              | —             | 543           |
|                                                      | <b>26,595</b>      | <b>4,304</b>      | <b>3,860</b>                    | <b>1,164</b>                   | <b>687</b>    | <b>36,610</b> |
| <i>Non-Core</i>                                      |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 2,071              | 9,498             | 138                             | 4,628                          | —             | 16,335        |
| 1-2 years                                            | 192                | 1,240             | 79                              | 3,714                          | —             | 5,225         |
| 2-3 years                                            | 99                 | 38                | 43                              | 1,137                          | —             | 1,317         |
| > 3 years                                            | 1,058              | 214               | 132                             | 1,935                          | —             | 3,339         |
| Not classified (2)                                   | 214                | —                 | —                               | —                              | —             | 214           |
|                                                      | <b>3,634</b>       | <b>10,990</b>     | <b>392</b>                      | <b>11,414</b>                  | <b>—</b>      | <b>26,430</b> |
| <b>2011</b>                                          |                    |                   |                                 |                                |               |               |
| <i>Core</i>                                          |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 8,268              | 3,030             | 1,056                           | 142                            | —             | 12,496        |
| 1-2 years                                            | 5,187              | 391               | 638                             | 218                            | 60            | 6,494         |
| 2-3 years                                            | 3,587              | 117               | 765                             | 230                            | 133           | 4,832         |
| > 3 years                                            | 10,871             | 1,225             | 1,846                           | 581                            | 9             | 14,532        |
| Not classified (2)                                   | 2,211              | —                 | —                               | —                              | —             | 2,211         |
|                                                      | <b>30,124</b>      | <b>4,763</b>      | <b>4,305</b>                    | <b>1,171</b>                   | <b>202</b>    | <b>40,565</b> |
| <i>Non-Core</i>                                      |                    |                   |                                 |                                |               |               |
| < 1 year (1)                                         | 3,224              | 11,089            | 293                             | 7,093                          | —             | 21,699        |
| 1-2 years                                            | 508                | 692               | 163                             | 3,064                          | —             | 4,427         |
| 2-3 years                                            | 312                | 177               | 152                             | 1,738                          | —             | 2,379         |
| > 3 years                                            | 1,636              | 392               | 321                             | 3,126                          | —             | 5,475         |
| Not classified (2)                                   | 297                | —                 | —                               | 4                              | —             | 301           |
|                                                      | <b>5,977</b>       | <b>12,350</b>     | <b>929</b>                      | <b>15,025</b>                  | <b>—</b>      | <b>34,281</b> |

#### Notes:

(1) Includes on demand and past due assets.

(2) Predominantly comprises overdrafts and multi-option facilities for which there is no single maturity date.

\*unaudited

## Financial review *Risk and balance sheet management*

### Key points

- The overall maturity profile remained relatively unchanged during 2013.
- The majority of Ulster Bank's commercial real estate portfolio was categorised as under one year, owing to the high level of non-performing assets in the portfolio.

| Commercial real estate portfolio by asset quality band | AQ1-AQ2<br>£m | AQ3-AQ4<br>£m | AQ5-AQ6<br>£m | AQ7-AQ8<br>£m | AQ9<br>£m | AQ10<br>£m | Total<br>£m |
|--------------------------------------------------------|---------------|---------------|---------------|---------------|-----------|------------|-------------|
| 2013                                                   |               |               |               |               |           |            |             |
| Core                                                   | 441           | 7,801         | 13,396        | 5,199         | 665       | 5,748      | 33,250      |
| Non-Core                                               | —             | 376           | 1,433         | 1,341         | 176       | 16,002     | 19,328      |
|                                                        | 441           | 8,177         | 14,829        | 6,540         | 841       | 21,750     | 52,578      |
| 2012                                                   |               |               |               |               |           |            |             |
| Core                                                   | 767           | 6,011         | 16,592        | 6,575         | 1,283     | 5,382      | 36,610      |
| Non-Core                                               | 177           | 578           | 3,680         | 3,200         | 1,029     | 17,766     | 26,430      |
|                                                        | 944           | 6,589         | 20,272        | 9,775         | 2,312     | 23,148     | 63,040      |
| 2011                                                   |               |               |               |               |           |            |             |
| Core                                                   | 1,094         | 6,714         | 19,054        | 6,254         | 3,111     | 4,338      | 40,565      |
| Non-Core                                               | 680           | 1,287         | 5,951         | 3,893         | 2,385     | 20,085     | 34,281      |
|                                                        | 1,774         | 8,001         | 25,005        | 10,147        | 5,496     | 24,423     | 74,846      |

### Key points

- There was an overall decrease in AQ10 during the year with reductions in Non-Core partially offset by increases in Ulster Bank. The high proportion of the portfolio in AQ10 was driven by exposure in Non-Core (Ulster Bank and International Banking) and Core (Ulster Bank).
- Of the total portfolio of £52.6 billion at 31 December 2013, £24.9 billion (2012 - £28.1 billion) was managed within the Group's standard credit processes. Another £2.9 billion (2012 - £5.1 billion) received varying degrees of heightened credit management under the Watchlist process. The decrease in the portfolio managed in the Group's Watchlist process occurred mainly in Non-Core and UK Corporate. The remaining £24.7 billion (2012 - £29.8 billion) was managed in GRG and included Watchlist and non-performing exposures.

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk: Key loan portfolios\* continued

The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value ratio, which represents loan value before provisions relative to the value of the property financed.

| Commercial real estate<br>loan-to-value ratio | Ulster Bank      |                      |             | Rest of the Group |                      |             | Group            |                      |             |
|-----------------------------------------------|------------------|----------------------|-------------|-------------------|----------------------|-------------|------------------|----------------------|-------------|
|                                               | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m  | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m |
| 2013                                          |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 124              | 23                   | 147         | 7,884             | 262                  | 8,146       | 8,008            | 285                  | 8,293       |
| > 50% and <= 70%                              | 271              | 55                   | 326         | 9,962             | 582                  | 10,544      | 10,233           | 637                  | 10,870      |
| > 70% and <= 90%                              | 282              | 89                   | 371         | 3,699             | 1,272                | 4,971       | 3,981            | 1,361                | 5,342       |
| > 90% and <= 100%                             | 86               | 154                  | 240         | 865               | 368                  | 1,233       | 951              | 522                  | 1,473       |
| > 100% and <= 110%                            | 121              | 212                  | 333         | 690               | 627                  | 1,317       | 811              | 839                  | 1,650       |
| > 110% and <= 130%                            | 238              | 366                  | 604         | 333               | 1,334                | 1,667       | 571              | 1,700                | 2,271       |
| > 130% and <= 150%                            | 102              | 438                  | 540         | 267               | 1,161                | 1,428       | 369              | 1,599                | 1,968       |
| > 150%                                        | 319              | 6,738                | 7,057       | 150               | 2,629                | 2,779       | 469              | 9,367                | 9,836       |
| Total with LTVs                               | 1,543            | 8,075                | 9,618       | 23,850            | 8,235                | 32,085      | 25,393           | 16,310               | 41,703      |
| Minimal security (1)                          | 6                | 3,144                | 3,150       | 54                | 13                   | 67          | 60               | 3,157                | 3,217       |
| Other (2)                                     | 144              | 1,351                | 1,495       | 5,230             | 933                  | 6,163       | 5,374            | 2,284                | 7,658       |
| Total                                         | 1,693            | 12,570               | 14,263      | 29,134            | 9,181                | 38,315      | 30,827           | 21,751               | 52,578      |
| Total portfolio average LTV (3)               | 121%             | 376%                 | 335%        | 61%               | 149%                 | 84%         | 65%              | 261%                 | 142%        |
| 2012 (4)                                      |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 141              | 18                   | 159         | 7,210             | 281                  | 7,491       | 7,351            | 299                  | 7,650       |
| > 50% and <= 70%                              | 309              | 58                   | 367         | 12,161            | 996                  | 13,157      | 12,470           | 1,054                | 13,524      |
| > 70% and <= 90%                              | 402              | 164                  | 566         | 6,438             | 1,042                | 7,480       | 6,840            | 1,206                | 8,046       |
| > 90% and <= 100%                             | 404              | 137                  | 541         | 1,542             | 2,145                | 3,687       | 1,946            | 2,282                | 4,228       |
| > 100% and <= 110%                            | 111              | 543                  | 654         | 1,019             | 1,449                | 2,468       | 1,130            | 1,992                | 3,122       |
| > 110% and <= 130%                            | 340              | 619                  | 959         | 901               | 1,069                | 1,970       | 1,241            | 1,688                | 2,929       |
| > 130% and <= 150%                            | 353              | 774                  | 1,127       | 322               | 913                  | 1,235       | 675              | 1,687                | 2,362       |
| > 150%                                        | 1,000            | 7,350                | 8,350       | 595               | 1,962                | 2,557       | 1,595            | 9,312                | 10,907      |
| Total with LTVs                               | 3,060            | 9,663                | 12,723      | 30,188            | 9,857                | 40,045      | 33,248           | 19,520               | 52,768      |
| Minimal security (1)                          | 8                | 1,615                | 1,623       | 3                 | 13                   | 16          | 11               | 1,628                | 1,639       |
| Other (2)                                     | 137              | 811                  | 948         | 6,494             | 1,191                | 7,685       | 6,631            | 2,002                | 8,633       |
| Total                                         | 3,205            | 12,089               | 15,294      | 36,685            | 11,061               | 47,746      | 39,890           | 23,150               | 63,040      |
| Total portfolio average LTV (3)               | 136%             | 286%                 | 250%        | 65%               | 125%                 | 80%         | 71%              | 206%                 | 122%        |

For notes to this table refer to the following page.

\*unaudited

## Financial review *Risk and balance sheet management*

| Commercial real estate<br>loan-to-value ratio | Ulster Bank      |                      |             | Rest of the Group |                      |             | Group            |                      |             |
|-----------------------------------------------|------------------|----------------------|-------------|-------------------|----------------------|-------------|------------------|----------------------|-------------|
|                                               | Performing<br>£m | Non-performing<br>£m | Total<br>£m | Performing<br>£m  | Non-performing<br>£m | Total<br>£m | Performing<br>£m | Non-performing<br>£m | Total<br>£m |
| 2011                                          |                  |                      |             |                   |                      |             |                  |                      |             |
| <= 50%                                        | 272              | 32                   | 304         | 7,091             | 332                  | 7,423       | 7,363            | 364                  | 7,727       |
| > 50% and <= 70%                              | 479              | 127                  | 606         | 14,105            | 984                  | 15,089      | 14,584           | 1,111                | 15,695      |
| > 70% and <= 90%                              | 808              | 332                  | 1,140       | 10,042            | 1,191                | 11,233      | 10,850           | 1,523                | 12,373      |
| > 90% and <= 100%                             | 438              | 201                  | 639         | 2,616             | 1,679                | 4,295       | 3,054            | 1,880                | 4,934       |
| > 100% and <= 110%                            | 474              | 390                  | 864         | 1,524             | 1,928                | 3,452       | 1,998            | 2,318                | 4,316       |
| > 110% and <= 130%                            | 527              | 1,101                | 1,628       | 698               | 1,039                | 1,737       | 1,225            | 2,140                | 3,365       |
| > 130% and <= 150%                            | 506              | 1,066                | 1,572       | 239               | 912                  | 1,151       | 745              | 1,978                | 2,723       |
| > 150%                                        | 912              | 7,472                | 8,384       | 433               | 2,082                | 2,515       | 1,345            | 9,554                | 10,899      |
| Total with LTVs                               | 4,416            | 10,721               | 15,137      | 36,748            | 10,147               | 46,895      | 41,164           | 20,868               | 62,032      |
| Minimal security (1)                          | 72               | 1,086                | 1,158       | —                 | —                    | —           | 72               | 1,086                | 1,158       |
| Other (2)                                     | 193              | 625                  | 818         | 8,994             | 1,844                | 10,838      | 9,187            | 2,469                | 11,656      |
| Total                                         | 4,681            | 12,432               | 17,113      | 45,742            | 11,991               | 57,733      | 50,423           | 24,423               | 74,846      |
| Total portfolio average LTV (3)               | 120%             | 264%                 | 222%        | 69%               | 129%                 | 82%         | 75%              | 203%                 | 116%        |

### Notes:

- (1) In 2012, the RBS Group reclassified loans with limited (defined as LTV>1,000%) or non-physical security as minimal security, of which a majority were commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect the relevant asset quality and recovery profile.
- (2) Other non-performing loans of £2.3 billion (2012 - £2.0 billion; 2011 - £2.5 billion) were subject to the Group's standard provisioning policies. Other performing loans of £5.4 billion (2012 - £6.6 billion; 2011 - £9.2 billion) included general corporate loans, typically unsecured, to commercial real estate companies, and major UK house builders in addition to facilities supported by guarantees. The credit quality of these exposures was consistent with that of the performing portfolio overall.
- (3) Weighted average by exposure.
- (4) 2012 LTV revised to reflect refinement to security value reporting implemented during 2013.

### Key points

- The reductions in the higher LTV buckets for the performing book were offset by the growth in these buckets in the non-performing book. Ulster Bank Group accounted for the majority of this deterioration and has addressed this through an increase in provisions (refer to the section on RCR). Ulster Bank Group's provision as a percentage of REIL stood at 76% at 31 December 2013 (2012 - 57%). Valuations continued to be affected by difficult, although improving, market conditions, as well as refinements to the Group's estimation approach.
- Interest payable on outstanding loans was covered 3.1x and 1.6x within UK Corporate and International Banking, respectively, at 31 December 2013 (2012 - 3.0x and 1.5x respectively). The US Retail & Commercial portfolio is managed on the basis of debt service coverage, which includes principal amortisation as well as interest payable. The average debt service coverage was 1.5x at 31 December 2013 (2012 - 1.3x). As a number of different approaches are used across the RBS Group and across geographies to calculate interest coverage ratios, they may not be comparable for different portfolio types and legal entities.

Credit quality metrics relating to commercial real estate lending were as follows:

|                                         | Group   |         |         | Non-Core |         |         |
|-----------------------------------------|---------|---------|---------|----------|---------|---------|
|                                         | 2013    | 2012    | 2011    | 2013     | 2012    | 2011    |
| Lending (gross)                         | £52.6bn | £63.0bn | £74.8bn | £19.3bn  | £26.4bn | £34.3bn |
| Of which REIL                           | £20.1bn | £22.1bn | £22.9bn | £14.3bn  | £17.1bn | £18.8bn |
| Provisions                              | £13.2bn | £10.1bn | £9.5bn  | £10.6bn  | £8.3bn  | £8.2bn  |
| REIL as a % of gross loans to customers | 38.2%   | 35.1%   | 30.6%   | 74.1%    | 64.8%   | 54.8%   |
| Provisions as a % of REIL               | 66%     | 46%     | 41%     | 74%      | 49%     | 44%     |

### Note:

- (1) Excludes property related lending to customers in other sectors managed by Real Estate Finance.

### Key point

- CRE lending net of impairment provisions decreased by £13.5 billion or 26% in the year to £39.4 billion in part due to the increased impairment provisions recorded in the fourth quarter of 2013 in Ulster Bank Non-Core, as part of RCR creation and related strategy. Provision coverage on CRE REIL was 66% compared to 46% at the end of 2012.

Ulster Bank is a significant contributor to Non-Core commercial real estate lending. For further information refer to the section on Ulster Bank Group (Core and Non-Core).

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk: Key loan portfolios\* continued

#### Residential mortgages

The table below analyses the mortgage portfolios and includes both Core and Non-Core. Total gross mortgage lending comprises 35% of the Group's gross lending of £418 billion.

|              | 2013<br>£m     | 2012<br>£m     | 2011<br>£m     |
|--------------|----------------|----------------|----------------|
| UK Retail    | 99,338         | 99,062         | 96,388         |
| Ulster Bank  | 19,034         | 19,162         | 20,020         |
| RBS Citizens | 19,584         | 21,538         | 24,153         |
| Wealth       | 8,701          | 8,786          | 8,468          |
|              | <b>146,657</b> | <b>148,548</b> | <b>149,029</b> |

Refer to pages 90 to 92 for further information on interest only loans.

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

|                                                     | UK Retail        |                          |               | Ulster Bank      |                          |               | RBS Citizens (1) |                          |               | Wealth           |                          |              |
|-----------------------------------------------------|------------------|--------------------------|---------------|------------------|--------------------------|---------------|------------------|--------------------------|---------------|------------------|--------------------------|--------------|
|                                                     | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m   | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m   | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m   | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m  |
| <i>Loan-to-value ratio</i>                          |                  |                          |               |                  |                          |               |                  |                          |               |                  |                          |              |
| 2013                                                |                  |                          |               |                  |                          |               |                  |                          |               |                  |                          |              |
| <= 50%                                              | 26,392           | 313                      | 26,705        | 2,025            | 170                      | 2,195         | 4,669            | 98                       | 4,767         | 3,400            | 16                       | 3,416        |
| > 50% and <= 70%                                    | 34,699           | 591                      | 35,290        | 1,837            | 195                      | 2,032         | 5,529            | 89                       | 5,618         | 3,397            | 20                       | 3,417        |
| > 70% and <= 90%                                    | 28,920           | 854                      | 29,774        | 2,326            | 288                      | 2,614         | 5,553            | 110                      | 5,663         | 1,337            | 44                       | 1,381        |
| > 90% and <= 100%                                   | 4,057            | 315                      | 4,372         | 1,214            | 162                      | 1,376         | 1,309            | 39                       | 1,348         | 87               | 7                        | 94           |
| > 100% and <= 110%                                  | 1,790            | 182                      | 1,972         | 1,302            | 182                      | 1,484         | 752              | 22                       | 774           | 87               | 15                       | 102          |
| > 110% and <= 130%                                  | 552              | 100                      | 652           | 2,509            | 461                      | 2,970         | 637              | 17                       | 654           | 27               | 6                        | 33           |
| > 130% and <= 150%                                  | 37               | 5                        | 42            | 2,202            | 549                      | 2,751         | 183              | 5                        | 188           | 4                | 4                        | 8            |
| > 150%                                              | —                | —                        | —             | 2,385            | 1,227                    | 3,612         | 102              | 4                        | 106           | 24               | 6                        | 30           |
| Total with LTVs                                     | 96,447           | 2,360                    | 98,807        | 15,800           | 3,234                    | 19,034        | 18,734           | 384                      | 19,118        | 8,363            | 118                      | 8,481        |
| Other (2)                                           | 511              | 20                       | 531           | —                | —                        | —             | 463              | 3                        | 466           | 215              | 5                        | 220          |
| Total                                               | <b>96,958</b>    | <b>2,380</b>             | <b>99,338</b> | <b>15,800</b>    | <b>3,234</b>             | <b>19,034</b> | <b>19,197</b>    | <b>387</b>               | <b>19,584</b> | <b>8,578</b>     | <b>123</b>               | <b>8,701</b> |
| Total portfolio average LTV (3)                     | 62%              | 75%                      | 62%           | 103%             | 130%                     | 108%          | 67%              | 69%                      | 67%           | 51%              | 77%                      | 51%          |
| Average LTV on new originations during the year (3) |                  |                          | 67%           |                  |                          | 73%           |                  |                          | 68%           |                  |                          | 52%          |
| 2012                                                |                  |                          |               |                  |                          |               |                  |                          |               |                  |                          |              |
| <= 50%                                              | 22,306           | 327                      | 22,633        | 2,182            | 274                      | 2,456         | 4,167            | 51                       | 4,218         | 3,905            | 9                        | 3,914        |
| > 50% and <= 70%                                    | 27,408           | 457                      | 27,865        | 1,635            | 197                      | 1,832         | 4,806            | 76                       | 4,882         | 2,790            | 12                       | 2,802        |
| > 70% and <= 90%                                    | 34,002           | 767                      | 34,769        | 2,019            | 294                      | 2,313         | 6,461            | 114                      | 6,575         | 1,080            | 27                       | 1,107        |
| > 90% and <= 100%                                   | 7,073            | 366                      | 7,439         | 1,119            | 156                      | 1,275         | 2,011            | 57                       | 2,068         | 93               | 7                        | 100          |
| > 100% and <= 110%                                  | 3,301            | 290                      | 3,591         | 1,239            | 174                      | 1,413         | 1,280            | 43                       | 1,323         | 69               | 13                       | 82           |
| > 110% and <= 130%                                  | 1,919            | 239                      | 2,158         | 2,412            | 397                      | 2,809         | 1,263            | 42                       | 1,305         | 49               | 7                        | 56           |
| > 130% and <= 150%                                  | 83               | 26                       | 109           | 2,144            | 474                      | 2,618         | 463              | 14                       | 477           | 16               | 3                        | 19           |
| > 150%                                              | —                | —                        | —             | 3,156            | 1,290                    | 4,446         | 365              | 14                       | 379           | 29               | 3                        | 32           |
| Total with LTVs                                     | 96,092           | 2,472                    | 98,564        | 15,906           | 3,256                    | 19,162        | 20,816           | 411                      | 21,227        | 8,031            | 81                       | 8,112        |
| Other (2)                                           | 486              | 12                       | 498           | —                | —                        | —             | 292              | 19                       | 311           | 674              | —                        | 674          |
| Total                                               | <b>96,578</b>    | <b>2,484</b>             | <b>99,062</b> | <b>15,906</b>    | <b>3,256</b>             | <b>19,162</b> | <b>21,108</b>    | <b>430</b>               | <b>21,538</b> | <b>8,705</b>     | <b>81</b>                | <b>8,786</b> |
| Total portfolio average LTV (3)                     | 66%              | 80%                      | 67%           | 108%             | 132%                     | 112%          | 75%              | 86%                      | 75%           | 51%              | 78%                      | 51%          |
| Average LTV on new originations during the year (3) |                  |                          | 65%           |                  |                          | 74%           |                  |                          | 64%           |                  |                          |              |

\*unaudited

## Financial review *Risk and balance sheet management*

|                                                     | UK Retail        |                          |             | Ulster Bank      |                          |             | RBS Citizens (1) |                          |             |
|-----------------------------------------------------|------------------|--------------------------|-------------|------------------|--------------------------|-------------|------------------|--------------------------|-------------|
|                                                     | Performing<br>£m | Non-<br>performing<br>£m | Total<br>£m | Performing<br>£m | Non-<br>Performing<br>£m | Total<br>£m | Performing<br>£m | Non-<br>Performing<br>£m | Total<br>£m |
| <i>Loan-to-value ratio</i>                          |                  |                          |             |                  |                          |             |                  |                          |             |
| 2011                                                |                  |                          |             |                  |                          |             |                  |                          |             |
| <= 50%                                              | 21,537           | 285                      | 21,822      | 2,568            | 222                      | 2,790       | 4,745            | 49                       | 4,794       |
| > 50% and <= 70%                                    | 25,598           | 390                      | 25,988      | 1,877            | 157                      | 2,034       | 4,713            | 78                       | 4,791       |
| > 70% and <= 90%                                    | 33,738           | 671                      | 34,409      | 2,280            | 223                      | 2,503       | 6,893            | 125                      | 7,018       |
| > 90% and <= 100%                                   | 7,365            | 343                      | 7,708       | 1,377            | 128                      | 1,505       | 2,352            | 66                       | 2,418       |
| > 100% and <= 110%                                  | 3,817            | 276                      | 4,093       | 1,462            | 130                      | 1,592       | 1,517            | 53                       | 1,570       |
| > 110% and <= 130%                                  | 1,514            | 199                      | 1,713       | 2,752            | 322                      | 3,074       | 1,536            | 53                       | 1,589       |
| > 130% and <= 150%                                  | 60               | 15                       | 75          | 2,607            | 369                      | 2,976       | 626              | 28                       | 654         |
| > 150%                                              | —                | —                        | —           | 2,798            | 748                      | 3,546       | 588              | 27                       | 615         |
| Total with LTVs                                     | 93,629           | 2,179                    | 95,808      | 17,721           | 2,299                    | 20,020      | 22,970           | 479                      | 23,449      |
| Other (2)                                           | 567              | 13                       | 580         | —                | —                        | —           | 681              | 23                       | 704         |
| Total                                               | 94,196           | 2,192                    | 96,388      | 17,721           | 2,299                    | 20,020      | 23,651           | 502                      | 24,153      |
| Total portfolio average LTV (3)                     | 67%              | 80%                      | 67%         | 104%             | 125%                     | 106%        | 76%              | 91%                      | 77%         |
| Average LTV on new originations during the year (3) |                  |                          | 63%         |                  |                          | 74%         |                  |                          | 63%         |

### Notes:

(1) Includes residential mortgages and home equity loans and lines (refer to page 88 for a breakdown of balances).

(2) Where no indexed LTV is held.

(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

### Key points

#### UK Retail

- The UK Retail mortgage portfolio was £99.3 billion at 31 December 2013, an increase of 0.3% from 31 December 2012. The mortgages included £9.1 billion (2012 - £7.9 billion) of residential buy-to-let lending.
- As at 31 December 2013, approximately 43% of the portfolio consisted of fixed rate, 5% a combination of fixed and variable rates and the remainder were variable rate mortgages (including those on managed rates). The interest only proportion of the total portfolio was 26%.
- Gross new mortgage lending amounted to £14.4 billion and the average LTV by volume was 62.7% compared to 61.3% at 31 December 2012. The average LTV calculated by weighted LTV of lending was 66.6% (2012 - 65.2%).
- Based on the Halifax Price Index at September 2013, the portfolio-average indexed LTV by volume was 54.1% (2012 - 58.1%) and 62.0% by weighted value of debt outstanding (2012 - 66.8%). The ratio of total outstanding balances to total indexed property valuations was 45.1% (2012 - 48.5%).
- All new mortgage business is subject to a comprehensive assessment. This includes: i) an affordability test which includes a stressed interest rate that is higher than the customer pay rate; ii) credit scoring; iii) a maximum loan-to-value of 90% with the exception of the UK Government backed schemes Help-to-Buy (from the fourth quarter of 2013), New Buy and My New Home products where lending of up to 95% is provided; and iv) a range of policy rules that restrict the availability of credit to borrowers with higher risk characteristics, for example highly indebted and/or adverse payment behaviour on previous borrowings.
- The arrears rate (defined as more than three payments in arrears, excluding reposessions and shortfalls post property sale), fell to 1.3% (2012 - 1.5%). The number of properties repossessed in 2013 was 1,532 compared with 1,426 in 2012. Arrears rates remained sensitive to economic developments and benefited from the low interest rate environment.
- The impairment charge for mortgage loans was £30 million for 2013 compared to £92 million in 2012, reflecting a lower level of defaults and reduced loss rates as valuations improved on properties held as security on defaulted debt.

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## Financial review *Risk and balance sheet management*

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### Credit risk: Key loan portfolios\* continued

#### Ulster Bank

- Ulster Bank's residential mortgage portfolio was £19.0 billion at 31 December 2013, with 88% in the Republic of Ireland and 12% in Northern Ireland. At constant exchange rates, the portfolio decreased 2.5% from 31 December 2012 as a result of amortisation and limited growth due to low market demand.
- The assets included £2.2 billion (12%) of residential buy-to-let loans. The interest rate product mix was approximately 68% on tracker rate products, 23% on variable rate products and 9% on fixed rate. Interest only represented 11% of the total portfolio.
- The average individual LTV on new originations was 73% in 2013, (2012 - 74%); the volume of new business remained very low. The maximum LTV available to Ulster Bank customers was 90% with the exception of a specific Northern Ireland scheme which permits LTVs of up to 95% (although Ulster Bank's exposure is capped at 85% LTV).
- The portfolio average indexed LTV fell 4% during 2013 and reflected positive house price index trends over the last 12 months.
- Refer to the Ulster Bank Group (Core and Non-Core) section on pages 93 to 95 for commentary on mortgage REIL and impairments.

#### RBS Citizens

- RBS Citizens residential real estate portfolio was £19.6 billion at 31 December 2013 (2012 - £21.5 billion). The Core business comprised 91% of the portfolio. The real estate portfolio consisted of £5.9 billion (£5.6 billion Core vs. £0.3 billion Non-Core) of first lien residential mortgages (1% in second lien position) and £13.5 billion (£12.0 billion Core vs. £1.5 billion Non-Core) of home equity loans and lines (first and second liens). Home equity Core consisted of 49% in first lien position while Non-Core consisted of 95% in second lien position.
- RBS Citizens continued to focus on its 'footprint states' of New England, Mid Atlantic and Mid West regions. At 31 December 2013, the portfolio consisted of £16.4 billion (84% of the total portfolio) within footprint.
- Of the total real estate portfolio of £1.8 billion in Non-Core, the serviced-by-others (SBO) element was the largest component (76%). The SBO book decreased from £1.8 billion at 31 December 2012 to £1.4 billion at 31 December 2013 and was closed to new purchases in the third quarter of 2007. The arrears rate of the SBO portfolio decreased from 1.9% at 31 December 2012 to 1.6% at 31 December 2013 reflecting portfolio liquidation as well as more effective account servicing and collections. The charge-off rate also continued to decrease (4.4% annualised at the fourth quarter of 2013 compared to 7.4% in 2012).
- The weighted average LTV of the portfolio decreased from 75% at 31 December 2012 to 67% at 31 December 2013, driven by increases in the Case-Shiller Home Price Index from the third quarter of 2012 to the fourth quarter of 2013. The weighted average LTV of the portfolio, excluding SBO, was 64%.

\*unaudited

## Financial review *Risk and balance sheet management*

### Personal lending

The Group's personal lending portfolio includes credit cards, unsecured loans, auto finance and overdrafts. The majority of personal lending exposures exist in the UK and the US. Impairment charge as a proportion of average loans and receivables is shown in the following table.

|                             | 2013                                      |                                                                            | 2012                                      |                                                                            | 2011                                      |                                                                            |
|-----------------------------|-------------------------------------------|----------------------------------------------------------------------------|-------------------------------------------|----------------------------------------------------------------------------|-------------------------------------------|----------------------------------------------------------------------------|
|                             | Average<br>loans and<br>receivables<br>£m | Impairment<br>charge as a %<br>of average<br>loans and<br>receivables<br>% | Average<br>loans and<br>receivables<br>£m | Impairment<br>charge as a %<br>of average<br>loans and<br>receivables<br>% | Average<br>loans and<br>receivables<br>£m | Impairment<br>charge as a %<br>of average<br>loans and<br>receivables<br>% |
| UK Retail cards (1)         | 5,626                                     | 2.0                                                                        | 5,624                                     | 2.3                                                                        | 5,675                                     | 3.0                                                                        |
| UK Retail loans (1)         | 5,761                                     | 1.6                                                                        | 6,513                                     | 2.5                                                                        | 7,755                                     | 2.8                                                                        |
| RBS Citizens cards (2)      | 903                                       | 3.9                                                                        | 916                                       | 3.8                                                                        | 936                                       | 5.1                                                                        |
| RBS Citizens auto loans (2) | 5,080                                     | 0.1                                                                        | 5,289                                     | 0.1                                                                        | 4,856                                     | 0.2                                                                        |

Notes:

(1) The ratio for UK Retail assets refers to the impairment charge for the year.

(2) The ratio for RBS Citizens refers to the impairment charge in the year, net of recoveries realised in the year.

### Key points

#### UK Retail

- The UK personal lending portfolio comprised credit cards, unsecured loans and overdrafts, and totalled £13.8 billion at 31 December 2013 (2012 - £14.7 billion). Loans fell 12%.
- The impairment charge on unsecured lending was £291 million for the year, down 34% on 2012. The decline reflected the effect of prior risk appetite tightening.
- The RBS Group continued to perform favourably relative to industry benchmarks for cards arrears.

#### RBS Citizens

- RBS Citizens credit card portfolio is comprised of good quality consumer loans originated in-footprint through the RBS Citizen's branch network and totalled £945 million at 31 December 2013 (2012 - £948 million). The product portfolio credit quality continued to improve with credit scores for new originations throughout 2013 higher than the portfolio average.
- Auto loans originated through dealer networks totalled £5.5 billion at 31 December 2013 (2012 - £5.4 billion). The portfolio maintained strong credit fundamentals. New origination credit and collateral characteristics throughout 2013 remained equally strong as a result of the short balance life and the resulting low collateral risk.

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk: Key loan portfolios\* continued

#### Interest only retail loans

The Group's interest only retail loan portfolios include interest only mortgage lending in UK Retail, Ulster Bank, Wealth and RBS Citizens' portfolios of home equity lines of credit (HELOC) and interest only mortgage portfolios.

|                     | 2013             |                    | 2012             |                        |
|---------------------|------------------|--------------------|------------------|------------------------|
|                     | Mortgages<br>£bn | Other loans<br>£bn | Mortgages<br>£bn | Other loans (1)<br>£bn |
| Variable rate       | 34.8             | 1.3                | 38.5             | 1.5                    |
| Fixed rate          | 8.0              | 0.1                | 8.1              | 0.1                    |
| Interest only loans | 42.8             | 1.4                | 46.6             | 1.6                    |
| Mixed repayment (2) | 8.3              | —                  | 8.8              | —                      |
| Total               | 51.1             | 1.4                | 55.4             | 1.6                    |

#### Notes:

(1) The other loans category for 2012 has been restated to exclude non-personal interest only loans within Wealth division.

(2) Mortgages with partial interest only and partial capital repayments.

The Group reduced its exposure to interest only mortgages. UK Retail ceased offering interest only mortgages to residential owner occupied customers with effect from 1 December 2012. Interest only repayment remains an option for buy-to-let mortgages. Ulster Bank withdrew interest only as a standard mortgage offering for new lending in the Republic of Ireland in 2010 and in Northern Ireland in 2012. Interest only mortgages are now granted on a very limited basis to high net worth customers or as part of its forbearance programme. RBS Citizens offers its customers interest only mortgages and conventional HELOC that enter an amortising repayment period after the interest only period. Wealth offers interest only mortgages to its high net worth customers.

The Group recognises impairment provisions in respect of loans in its interest only portfolios (UK Retail - 2 years; RBS Citizens - 1 year) that are approaching their contractual maturity based on historical analysis and customer behaviour. These impairment provisions are refreshed as new trends and data become available.

The tables below analyse the Group's interest only mortgage and HELOC portfolios (excluding mixed repayment mortgages) by type, by contractual year of maturity and by originating division.

| 2013                           | 2014 (1)<br>£bn | 2015-16<br>£bn | 2017-21<br>£bn | 2022-26<br>£bn | 2027-31<br>£bn | 2032-41<br>£bn | After 2041<br>£bn | Total<br>£bn |
|--------------------------------|-----------------|----------------|----------------|----------------|----------------|----------------|-------------------|--------------|
| Bullet principal repayment (2) | 0.9             | 2.1            | 6.0            | 7.6            | 7.9            | 7.5            | 0.5               | 32.5         |
| Conversion to amortising (2,3) | 1.9             | 6.0            | 2.2            | 0.1            | —              | 0.1            | —                 | 10.3         |
| Total                          | 2.8             | 8.1            | 8.2            | 7.7            | 7.9            | 7.6            | 0.5               | 42.8         |

| 2012                           | 2013 (4)<br>£bn | 2014-15<br>£bn | 2016-20<br>£bn | 2021-25<br>£bn | 2026-30<br>£bn | 2031-40<br>£bn | After 2040<br>£bn | Total<br>£bn |
|--------------------------------|-----------------|----------------|----------------|----------------|----------------|----------------|-------------------|--------------|
| Bullet principal repayment (2) | 1.4             | 2.9            | 6.8            | 5.9            | 8.1            | 9.9            | 0.7               | 35.7         |
| Conversion to amortising (2,3) | 0.5             | 1.7            | 5.8            | 2.7            | 0.1            | 0.1            | —                 | 10.9         |
| Total                          | 1.9             | 4.6            | 12.6           | 8.6            | 8.2            | 10.0           | 0.7               | 46.6         |

#### Notes:

(1) 2014 includes pre-2014 maturity exposure.

(2) Includes £2.3 billion (2012 - £2.2 billion) of repayment mortgages that have been granted interest only concessions (forbearance).

(3) Maturity date relates to the expiry of the interest only period.

(4) 2013 includes pre-2013 maturity exposure.

\*unaudited

## Financial review *Risk and balance sheet management*

|                          | 2013                              |                                 |              |                                     | 2012                              |                                 |              |                                     |
|--------------------------|-----------------------------------|---------------------------------|--------------|-------------------------------------|-----------------------------------|---------------------------------|--------------|-------------------------------------|
|                          | Bullet principal repayment<br>£bn | Conversion to amortising<br>£bn | Total<br>£bn | Proportion of mortgage lending<br>% | Bullet principal repayment<br>£bn | Conversion to amortising<br>£bn | Total<br>£bn | Proportion of mortgage lending<br>% |
| UK Retail <sup>(1)</sup> | 25.4                              | —                               | 25.4         | 25.6                                | 28.1                              | —                               | 28.1         | 28.4                                |
| Ulster Bank              | 0.7                               | 1.4                             | 2.1          | 11.0                                | 1.4                               | 1.8                             | 3.2          | 16.7                                |
| RBS Citizens             | 0.4                               | 8.9                             | 9.3          | 47.5                                | 0.5                               | 9.0                             | 9.5          | 44.1                                |
| Wealth                   | 6.0                               | —                               | 6.0          | 69.0                                | 5.7                               | 0.1                             | 5.8          | 66.0                                |
| <b>Total</b>             | <b>32.5</b>                       | <b>10.3</b>                     | <b>42.8</b>  |                                     | <b>35.7</b>                       | <b>10.9</b>                     | <b>46.6</b>  |                                     |

Note:

(1) UK Retail also has exposure of £7.7 billion to customers who have a combination of repayment types, capital repayments and interest only.

### UK Retail

UK Retail's interest only mortgages require full principal repayment - which is known as bullet repayment - at the time of maturity. Typically such loans have remaining terms of between 15 and 20 years. Customers are reminded of the need to have an adequate repayment vehicle in place during the mortgage term.

Of the bullet loans that matured in the six months to 30 June 2013, 53% had been fully repaid by 31 December 2013. The unpaid balance totalled £51 million, 96% of which continued to meet agreed payment arrangements (including balances that have been restructured on a capital and interest basis within eight months of the contract date; customers are allowed eight months leeway for their investment plan to mature and cashed in to repay the mortgage). Of the £51 million unpaid balance, 56% of the loans had an indexed LTV of 70% or less with only 14% above 90%. Customers may be offered a short extension to the term of an interest only mortgage or a conversion of an interest only mortgage to one featuring repayment of both capital and interest, subject to affordability and characteristics such as the customer's income and ultimate repayment vehicle. The majority of term extensions in UK Retail are classified as forbearance.

### Ulster Bank

Ulster Bank's interest only mortgages require full principal repayment (bullet) at the time of maturity; or payment of both capital and interest from the end of the interest only period, typically seven years, so that customers meet their contractual repayment obligations. For bullet customers, contact strategies are in place to remind them of the need to repay principal at the end of the mortgage term.

Of the bullet loans that matured in the six months to 30 June 2013 (£1.2 million), 20% had fully repaid by 31 December 2013 leaving residual balances of £0.9 million, 78% of which were meeting the terms of a revised repayment schedule. Of the amortising loans that matured in the six months to 30 June 2013 (£65 million), 69% were either fully repaid or meeting the terms of a revised repayment schedule.

Ulster Bank also offers temporary interest only periods to customers as part of its forbearance programme. An interest only period of up to two years is permitted after which the customer enters an amortising repayment period following further assessment of the customer's circumstances. The affordability assessment conducted at the end of the forbearance period takes into consideration the repayment of the arrears that have accumulated based on original terms during the forbearance period. The customer's delinquency status does not deteriorate further while forbearance repayments are maintained. Term extensions in respect of existing interest only mortgages are offered only under a forbearance arrangement.

### RBS Citizens

RBS Citizens has a book of interest only bullet repayment HELOC loans (£0.4 billion at 31 December 2013) for which repayment of principal is due at maturity, and an interest only portfolio that comprises loans that convert to amortising after an interest only period that is typically 10 years (£8.9 billion at December 2013 of which £8.0 billion are HELOCs). The majority of the bullet loans are due to mature between 2014 and 2015. Of the bullet loans that matured in the six months to 30 June 2013, 50% had fully repaid or are current as of 31 December 2013. The residual balances (modified, delinquent, and charged-off) made up £21 million. For those loans that convert to amortising, the typical uplift in payments is currently 210% (average uplift calculated at £132 per month). Delinquency rates have shown a modest increase in the over 30 days arrears rate.

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk: Key loan portfolios\* continued

The tables below analyse the Group's retail mortgage and HELOC portfolios between interest only mortgages (excluding mixed repayment mortgages) and other mortgage loans.

|                         | Interest only                        |                                    | Other<br>£bn | Total<br>£bn |
|-------------------------|--------------------------------------|------------------------------------|--------------|--------------|
|                         | Bullet principal<br>Repayment<br>£bn | Conversion to<br>amortising<br>£bn |              |              |
| 2013                    |                                      |                                    |              |              |
| Arrears status          |                                      |                                    |              |              |
| Current                 | 31.2                                 | 9.6                                | 97.0         | 137.8        |
| 1 to 90 days in arrears | 0.7                                  | 0.4                                | 2.8          | 3.9          |
| 90+ days in arrears     | 0.6                                  | 0.3                                | 4.1          | 5.0          |
| Total                   | 32.5                                 | 10.3                               | 103.9        | 146.7        |

|                         |      |      |       |       |
|-------------------------|------|------|-------|-------|
| 2012                    |      |      |       |       |
| Arrears status          |      |      |       |       |
| Current                 | 34.4 | 10.0 | 94.4  | 138.8 |
| 1 to 90 days in arrears | 0.6  | 0.4  | 3.3   | 4.3   |
| 90+ days in arrears     | 0.7  | 0.5  | 4.2   | 5.4   |
| Total                   | 35.7 | 10.9 | 101.9 | 148.5 |

|                    | Interest only | Other | Total |
|--------------------|---------------|-------|-------|
| 2013               | £bn           | £bn   | £bn   |
| Current LTV        |               |       |       |
| <= 50%             | 10.8          | 26.3  | 37.1  |
| > 50% and <= 70%   | 14.6          | 31.8  | 46.4  |
| > 70% and <= 90%   | 10.8          | 28.6  | 39.4  |
| > 90% and <= 100%  | 2.6           | 4.6   | 7.2   |
| > 100% and <= 110% | 1.5           | 2.8   | 4.3   |
| > 110% and <= 130% | 0.9           | 3.4   | 4.3   |
| > 130% and <= 150% | 0.5           | 2.5   | 3.0   |
| > 150%             | 0.7           | 3.1   | 3.8   |
| Total with LTVs    | 42.4          | 103.1 | 145.5 |
| Other              | 0.4           | 0.8   | 1.2   |
| Total              | 42.8          | 103.9 | 146.7 |

|                    |  |      |       |       |
|--------------------|--|------|-------|-------|
| 2012               |  |      |       |       |
| Current LTV        |  |      |       |       |
| <= 50%             |  | 10.3 | 22.9  | 33.2  |
| > 50% and <= 70%   |  | 12.4 | 25.0  | 37.4  |
| > 70% and <= 90%   |  | 13.6 | 31.2  | 44.8  |
| > 90% and <= 100%  |  | 3.6  | 7.3   | 10.9  |
| > 100% and <= 110% |  | 2.4  | 4.0   | 6.4   |
| > 110% and <= 130% |  | 2.0  | 4.3   | 6.3   |
| > 130% and <= 150% |  | 0.8  | 2.4   | 3.2   |
| > 150%             |  | 1.2  | 3.7   | 4.9   |
| Total with LTVs    |  | 46.3 | 100.8 | 147.1 |
| Other              |  | 0.3  | 1.1   | 1.4   |
| Total              |  | 46.6 | 101.9 | 148.5 |

\*unaudited

## Financial review Risk and balance sheet management

### Ulster Bank Group (Core and Non-Core)

#### Overview

At 31 December 2013, Ulster Bank Group accounted for 10% of the Group's total gross loans to customers (2012 and 2011 - 10%) and 8% of the Group's Core gross loans to customers (2012 and 2011 - 8%) Ulster Bank's financial performance continued to be impacted by the challenging economic climate in Ireland, with impairments remaining elevated in the wholesale bank as a result of limited liquidity in the economy which continues to depress the property market and domestic spending. Additionally, in the fourth quarter of 2013 the Group announced a recovery strategy for loans transferring to RCR. This resulted in a significant increase in provisions as the move from a through the cycle strategy to a 3 year deleverage, reduced expected realisations.

The impairment charge of £4,793 million for 2013 (2012 - £2,340 million; 2011 - £3,717 million) was driven by a combination of new defaulting customers and higher provisions on existing defaulted cases due primarily to the above mentioned RCR strategy. Provisions as a percentage of risk elements in lending increased to 76% in 2013, from 57% in 2012, predominantly as a result of this change in strategy, combined with the deterioration in the value of the Non-Core commercial real estate development portfolio.

#### Core

The impairment charge for the year of £1,774 million (2012 - £1,364 million; 2011 - £1,384 million) reflected the difficult economic climate in Ireland, and most particularly the RCR deleverage strategy across the corporate portfolios. The mortgage portfolio improved notably in 2013, accounting for £235 million (13%) of the total 2013 impairment charge (2012 - £646 million; 2011 - £570 million) due to lower debt flows driven by improved collections performance and stabilising residential property prices.

#### Non-Core

The impairment charge for the year was £3,019 million (2012 - £976 million; 2011 - £2,333 million), with the commercial real estate sector accounting for £2,674 million (89%) of the total 2013 impairment charge, again reflecting the RCR strategy.

The table below analyses Ulster Bank Group's loans, REIL, impairments and related credit metrics by sector.

| Sector analysis          | Gross loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                  |                                |                                       | Impairment charge (1)<br>£m | Amounts written-off<br>£m |
|--------------------------|-------------------|------------|------------------|---------------------------------|--------------------------------|---------------------------------------|-----------------------------|---------------------------|
|                          |                   |            |                  | REIL as a % of gross loans<br>% | Provisions as a % of REIL<br>% | Provisions as a % of gross loans<br>% |                             |                           |
| 2013                     |                   |            |                  |                                 |                                |                                       |                             |                           |
| <b>Core</b>              |                   |            |                  |                                 |                                |                                       |                             |                           |
| Mortgages                | 19,034            | 3,235      | 1,725            | 17.0                            | 53                             | 9.1                                   | 235                         | 34                        |
| Commercial real estate   |                   |            |                  |                                 |                                |                                       |                             |                           |
| - investment             | 3,419             | 2,288      | 1,151            | 66.9                            | 50                             | 33.7                                  | 593                         | 51                        |
| - development            | 718               | 472        | 331              | 65.7                            | 70                             | 46.1                                  | 153                         | 4                         |
| Other corporate          | 7,039             | 2,277      | 1,984            | 32.3                            | 87                             | 28.2                                  | 771                         | 149                       |
| Other lending            | 1,236             | 194        | 187              | 15.7                            | 96                             | 15.1                                  | 22                          | 39                        |
|                          | 31,446            | 8,466      | 5,378            | 26.9                            | 64                             | 17.1                                  | 1,774                       | 277                       |
| <b>Non-Core</b>          |                   |            |                  |                                 |                                |                                       |                             |                           |
| Commercial real estate   |                   |            |                  |                                 |                                |                                       |                             |                           |
| - investment             | 3,211             | 3,006      | 2,162            | 93.6                            | 72                             | 67.3                                  | 837                         | 53                        |
| - development            | 6,915             | 6,757      | 6,158            | 97.7                            | 91                             | 89.1                                  | 1,837                       | 370                       |
| Other corporate          | 1,479             | 1,209      | 1,069            | 81.7                            | 88                             | 72.3                                  | 345                         | 6                         |
|                          | 11,605            | 10,972     | 9,389            | 94.5                            | 86                             | 80.9                                  | 3,019                       | 429                       |
| <b>Ulster Bank Group</b> |                   |            |                  |                                 |                                |                                       |                             |                           |
| Mortgages                | 19,034            | 3,235      | 1,725            | 17.0                            | 53                             | 9.1                                   | 235                         | 34                        |
| Commercial real estate   |                   |            |                  |                                 |                                |                                       |                             |                           |
| - investment             | 6,630             | 5,294      | 3,313            | 79.8                            | 63                             | 50.0                                  | 1,430                       | 104                       |
| - development            | 7,633             | 7,229      | 6,489            | 94.7                            | 90                             | 85.0                                  | 1,990                       | 374                       |
| Other corporate          | 8,518             | 3,486      | 3,053            | 40.9                            | 88                             | 35.8                                  | 1,116                       | 155                       |
| Other lending            | 1,236             | 194        | 187              | 15.7                            | 96                             | 15.1                                  | 22                          | 39                        |
|                          | 43,051            | 19,438     | 14,767           | 45.2                            | 76                             | 34.3                                  | 4,793                       | 706                       |

Note:

(1) Of which £3.2 billion was due to RCR and the related change of strategy.

\*unaudited

## Financial review *Risk and balance sheet management*

### Credit risk continued

#### Key loan portfolios\* continued

| Sector analysis        | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                        |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a % of<br>REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2012                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Core                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Mortgages              | 19,162               | 3,147      | 1,525            | 16.4                                  | 48                                   | 8.0                                         | 646                        | 22                           |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 3,575                | 1,551      | 593              | 43.4                                  | 38                                   | 16.6                                        | 221                        | —                            |
| - development          | 729                  | 369        | 197              | 50.6                                  | 53                                   | 27.0                                        | 55                         | 2                            |
| Other corporate        | 7,772                | 2,259      | 1,394            | 29.1                                  | 62                                   | 17.9                                        | 389                        | 15                           |
| Other lending          | 1,414                | 207        | 201              | 14.6                                  | 97                                   | 14.2                                        | 53                         | 33                           |
|                        | 32,652               | 7,533      | 3,910            | 23.1                                  | 52                                   | 12.0                                        | 1,364                      | 72                           |
| Non-Core               |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 3,383                | 2,800      | 1,433            | 82.8                                  | 51                                   | 42.4                                        | 288                        | 15                           |
| - development          | 7,607                | 7,286      | 4,720            | 95.8                                  | 65                                   | 62.0                                        | 611                        | 103                          |
| Other corporate        | 1,570                | 1,230      | 711              | 78.3                                  | 58                                   | 45.3                                        | 77                         | 23                           |
|                        | 12,560               | 11,316     | 6,864            | 90.1                                  | 61                                   | 54.6                                        | 976                        | 141                          |
| Ulster Bank Group      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Mortgages              | 19,162               | 3,147      | 1,525            | 16.4                                  | 48                                   | 8.0                                         | 646                        | 22                           |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 6,958                | 4,351      | 2,026            | 62.5                                  | 47                                   | 29.1                                        | 509                        | 15                           |
| - development          | 8,336                | 7,655      | 4,917            | 91.8                                  | 64                                   | 59.0                                        | 666                        | 105                          |
| Other corporate        | 9,342                | 3,489      | 2,105            | 37.3                                  | 60                                   | 22.5                                        | 466                        | 38                           |
| Other lending          | 1,414                | 207        | 201              | 14.6                                  | 97                                   | 14.2                                        | 53                         | 33                           |
|                        | 45,212               | 18,849     | 10,774           | 41.7                                  | 57                                   | 23.8                                        | 2,340                      | 213                          |
| 2011                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Core                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Mortgages              | 20,020               | 2,184      | 945              | 10.9                                  | 43                                   | 4.7                                         | 570                        | 11                           |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 3,882                | 1,014      | 413              | 26.1                                  | 41                                   | 10.6                                        | 225                        | —                            |
| - development          | 881                  | 290        | 145              | 32.9                                  | 50                                   | 16.5                                        | 99                         | 16                           |
| Other corporate        | 7,736                | 1,834      | 1,062            | 23.7                                  | 58                                   | 13.7                                        | 434                        | 72                           |
| Other lending          | 1,533                | 201        | 184              | 13.1                                  | 92                                   | 12.0                                        | 56                         | 25                           |
|                        | 34,052               | 5,523      | 2,749            | 16.2                                  | 50                                   | 8.1                                         | 1,384                      | 124                          |
| Non-Core               |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 3,860                | 2,916      | 1,364            | 75.5                                  | 47                                   | 35.3                                        | 609                        | 1                            |
| - development          | 8,490                | 7,536      | 4,295            | 88.8                                  | 57                                   | 50.6                                        | 1,551                      | 32                           |
| Other corporate        | 1,630                | 1,159      | 642              | 71.1                                  | 55                                   | 39.4                                        | 173                        | 16                           |
|                        | 13,980               | 11,611     | 6,301            | 83.1                                  | 54                                   | 45.1                                        | 2,333                      | 49                           |
| Ulster Bank Group      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Mortgages              | 20,020               | 2,184      | 945              | 10.9                                  | 43                                   | 4.7                                         | 570                        | 11                           |
| Commercial real estate |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - investment           | 7,742                | 3,930      | 1,777            | 50.8                                  | 45                                   | 23.0                                        | 834                        | 1                            |
| - development          | 9,371                | 7,826      | 4,440            | 83.5                                  | 57                                   | 47.4                                        | 1,650                      | 48                           |
| Other corporate        | 9,366                | 2,993      | 1,704            | 32.0                                  | 57                                   | 18.2                                        | 607                        | 88                           |
| Other lending          | 1,533                | 201        | 184              | 13.1                                  | 92                                   | 12.0                                        | 56                         | 25                           |
|                        | 48,032               | 17,134     | 9,050            | 35.7                                  | 53                                   | 18.8                                        | 3,717                      | 173                          |

\*unaudited

## Financial review *Risk and balance sheet management*

### Key points

- The commercial real estate lending portfolio for Ulster Bank Group (Core and Non-Core) totalled £14.3 billion at 31 December 2013, of which £10.1 billion or 71% was in Non-Core. The geographic split of the total Ulster Bank Group commercial real estate portfolio remained similar to 2012 with 64% (2012 - 63%) in the Republic of Ireland, 26% (2012 - 26%) in Northern Ireland, 10% (2012 - 11%) in the UK (excluding Northern Ireland) and the balance (0.1%) in Rest of World (primarily Europe).
- Provisions covered CRE REIL by 78%, up from 58% at the end of 2012, with the investment portfolio being covered 80% and the development portfolio 95%.
- Of the total corporate impairment charge recorded during the second half of 2013 of £3.9 billion, £3.4 billion related to all loans that will be transferred to RCR, of which £2.9 billion related to commercial real estate loans and £0.5 billion related to corporate loans.

|                        | Investment |             | Development |             |        |
|------------------------|------------|-------------|-------------|-------------|--------|
|                        | Commercial | Residential | Commercial  | Residential | Total  |
|                        | £m         | £m          | £m          | £m          | £m     |
| Commercial real estate |            |             |             |             |        |
| 2013                   |            |             |             |             |        |
| ROI                    | 3,227      | 806         | 1,402       | 3,684       | 9,119  |
| NI                     | 1,083      | 223         | 517         | 1,848       | 3,671  |
| UK (excluding NI)      | 1,232      | 50          | 56          | 112         | 1,450  |
| RoW                    | 9          | —           | 8           | 6           | 23     |
|                        | 5,551      | 1,079       | 1,983       | 5,650       | 14,263 |
| 2012                   |            |             |             |             |        |
| ROI                    | 3,546      | 779         | 1,603       | 3,653       | 9,581  |
| NI                     | 1,083      | 210         | 631         | 2,059       | 3,983  |
| UK (excluding NI)      | 1,239      | 86          | 82          | 290         | 1,697  |
| RoW                    | 14         | 1           | 8           | 10          | 33     |
|                        | 5,882      | 1,076       | 2,324       | 6,012       | 15,294 |
| 2011                   |            |             |             |             |        |
| ROI                    | 3,775      | 853         | 1,911       | 4,095       | 10,634 |
| NI                     | 1,322      | 279         | 680         | 2,222       | 4,503  |
| UK (excluding NI)      | 1,371      | 111         | 95          | 336         | 1,913  |
| RoW                    | 27         | 4           | —           | 32          | 63     |
|                        | 6,495      | 1,247       | 2,686       | 6,685       | 17,113 |

### Key points

- Commercial real estate continued to be the primary sector driving the Ulster Bank Group defaulted loan book. Exposure to the sector fell during 2013 by £1.0 billion, reflecting Ulster Bank's continuing strategy to reduce concentration risk in this sector.
- Ulster Bank experienced further migration of commercial real estate exposures to its problem management framework, where various measures may be agreed to assist customers whose loans are performing, but who are experiencing temporary financial difficulties.
- The outlook for the property sector remains challenging. While there may be some signs of stabilisation in main urban centres, the outlook continues to be negative for secondary property locations on the island of Ireland.

### Residential mortgages

Mortgage lending portfolio analysis by country of location of the underlying security is set out below.

|     | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    |
|-----|---------------|---------------|---------------|
| ROI | 16,779        | 16,873        | 17,767        |
| NI  | 2,255         | 2,289         | 2,253         |
|     | <b>19,034</b> | <b>19,162</b> | <b>20,020</b> |

\*unaudited



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## ***Financial review Risk and balance sheet management***

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### **Balance sheet analysis**

|     |                                       |
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## Financial review *Risk and balance sheet management*

### Balance sheet analysis

#### Financial assets

##### Exposure summary

The table below analyses the Group's financial asset exposures, both gross and net of offset arrangements.

|                                                          | Group                |                       |                      |                                |                            |
|----------------------------------------------------------|----------------------|-----------------------|----------------------|--------------------------------|----------------------------|
|                                                          | Gross exposure<br>£m | IFRS offset (1)<br>£m | Carrying value<br>£m | Balance sheet offset (2)<br>£m | Exposure post offset<br>£m |
| <b>2013</b>                                              |                      |                       |                      |                                |                            |
| Cash and balances at central banks                       | 79,993               | —                     | 79,993               | —                              | 79,993                     |
| Reverse repos                                            | 116,994              | (40,658)              | 76,336               | (11,379)                       | 64,957                     |
| Lending                                                  | 414,721              | (2,152)               | 412,569              | (32,249)                       | 380,320                    |
| Debt securities                                          | 100,595              | —                     | 100,595              | —                              | 100,595                    |
| Equity shares                                            | 8,278                | —                     | 8,278                | —                              | 8,278                      |
| Derivatives                                              | 551,699              | (265,709)             | 285,990              | (266,383)                      | 19,607                     |
| Settlement balances                                      | 8,252                | (2,672)               | 5,580                | (262)                          | 5,318                      |
| Total excluding disposal groups                          | 1,280,532            | (311,191)             | 969,341              | (310,273)                      | 659,068                    |
| Total including disposal groups                          | 1,281,237            | (311,191)             | 970,046              | (310,273)                      | 659,773                    |
| Amounts due from holding company and fellow subsidiaries | 20,246               | —                     | 20,246               | (1,591)                        | 18,655                     |
| Gross of short positions                                 | 1,301,483            | (311,191)             | 990,292              | (311,864)                      | 678,428                    |
| Short positions                                          | (28,004)             | —                     | (28,004)             | —                              | (28,004)                   |
| Net of short positions                                   | 1,273,479            | (311,191)             | 962,288              | (311,864)                      | 650,424                    |
| <b>2012</b>                                              |                      |                       |                      |                                |                            |
| Cash and balances at central banks                       | 74,524               | —                     | 74,524               | —                              | 74,524                     |
| Reverse repos                                            | 142,864              | (38,377)              | 104,487              | (17,439)                       | 87,048                     |
| Lending                                                  | 448,676              | —                     | 448,676              | (34,853)                       | 413,823                    |
| Debt securities                                          | 136,406              | —                     | 136,406              | —                              | 136,406                    |
| Equity shares                                            | 13,872               | —                     | 13,872               | —                              | 13,872                     |
| Derivatives                                              | 811,349              | (373,448)             | 437,901              | (407,208)                      | 30,693                     |
| Settlement balances                                      | 8,173                | (2,456)               | 5,717                | (1,760)                        | 3,957                      |
| Total excluding disposal groups                          | 1,635,864            | (414,281)             | 1,221,583            | (461,260)                      | 760,323                    |
| Total including disposal groups                          | 1,636,168            | (414,281)             | 1,221,887            | (461,260)                      | 760,627                    |
| Amounts due from holding company and fellow subsidiaries | 31,120               | —                     | 31,120               | —                              | 31,120                     |
| Gross of short positions                                 | 1,667,288            | (414,281)             | 1,253,007            | (461,260)                      | 791,747                    |
| Short positions                                          | (27,541)             | —                     | (27,541)             | —                              | (27,541)                   |
| Net of short positions                                   | 1,639,747            | (414,281)             | 1,225,466            | (461,260)                      | 764,206                    |
| <b>2011</b>                                              |                      |                       |                      |                                |                            |
| Cash and balances at central banks                       | 68,487               | —                     | 68,487               | —                              | 68,487                     |
| Reverse repos                                            | 136,601              | (37,584)              | 99,017               | (15,246)                       | 83,771                     |
| Lending                                                  | 459,498              | —                     | 459,498              | (40,106)                       | 419,392                    |
| Debt securities                                          | 168,339              | —                     | 168,339              | —                              | 168,339                    |
| Equity shares                                            | 11,762               | —                     | 11,762               | —                              | 11,762                     |
| Derivatives                                              | 1,066,634            | (544,207)             | 522,427              | (477,305)                      | 45,122                     |
| Settlement balances                                      | 8,261                | (1,359)               | 6,902                | (2,188)                        | 4,714                      |
| Other financial assets                                   | 32                   | —                     | 32                   | —                              | 32                         |
| Total excluding disposal groups                          | 1,919,614            | (583,150)             | 1,336,464            | (534,845)                      | 801,619                    |
| Total including disposal groups                          | 1,938,938            | (583,150)             | 1,355,788            | (534,845)                      | 820,943                    |
| Amounts due from holding company and fellow subsidiaries | 39,206               | —                     | 39,206               | —                              | 39,206                     |
| Gross of short positions                                 | 1,978,144            | (583,150)             | 1,394,994            | (534,845)                      | 860,149                    |
| Short positions                                          | (40,446)             | —                     | (40,446)             | —                              | (40,446)                   |
| Net of short positions                                   | 1,937,698            | (583,150)             | 1,354,548            | (534,845)                      | 819,703                    |

For the notes to these tables refer to page 98.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Financial assets continued

The table below analyses the Bank's financial asset exposures, both gross and net of offset arrangements.

|                                                   |                      |                       | Bank                 |                                |                            |
|---------------------------------------------------|----------------------|-----------------------|----------------------|--------------------------------|----------------------------|
|                                                   | Gross exposure<br>£m | IFRS offset (1)<br>£m | Carrying value<br>£m | Balance sheet offset (2)<br>£m | Exposure post offset<br>£m |
| <b>2013</b>                                       |                      |                       |                      |                                |                            |
| Cash and balances at central banks                | 75,792               | —                     | 75,792               | —                              | 75,792                     |
| Reverse repos                                     | 60,913               | (17,151)              | 43,762               | (7,319)                        | 36,443                     |
| Lending                                           | 170,477              | (2,152)               | 168,325              | (23,981)                       | 144,344                    |
| Debt securities                                   | 65,484               | —                     | 65,484               | —                              | 65,484                     |
| Equity shares                                     | 7,301                | —                     | 7,301                | —                              | 7,301                      |
| Derivatives                                       | 549,399              | (265,486)             | 283,913              | (266,219)                      | 17,694                     |
| Settlement balances                               | 3,264                | (62)                  | 3,202                | —                              | 3,202                      |
| Total                                             | 932,630              | (284,851)             | 647,779              | (297,519)                      | 350,260                    |
| Amounts due from holding company and subsidiaries | 127,155              | —                     | 127,155              | (3,870)                        | 123,285                    |
| Gross of short positions                          | 1,059,785            | (284,851)             | 774,934              | (301,389)                      | 473,545                    |
| Short positions                                   | (17,898)             | —                     | (17,898)             | —                              | (17,898)                   |
| Net of short positions                            | 1,041,887            | (284,851)             | 757,036              | (301,389)                      | 455,647                    |
| <b>2012</b>                                       |                      |                       |                      |                                |                            |
| Cash and balances at central banks                | 70,374               | —                     | 70,374               | —                              | 70,374                     |
| Reverse repos                                     | 78,686               | (10,097)              | 68,589               | (14,762)                       | 53,827                     |
| Lending                                           | 191,392              | —                     | 191,392              | (27,788)                       | 163,604                    |
| Debt securities                                   | 89,150               | —                     | 89,150               | —                              | 89,150                     |
| Equity shares                                     | 12,766               | —                     | 12,766               | —                              | 12,766                     |
| Derivatives                                       | 808,149              | (373,264)             | 434,885              | (407,183)                      | 27,702                     |
| Settlement balances                               | 3,562                | (472)                 | 3,090                | (360)                          | 2,730                      |
| Total excluding disposal groups                   | 1,254,079            | (383,833)             | 870,246              | (450,093)                      | 420,153                    |
| Total including disposal groups                   | 1,254,079            | (383,833)             | 870,246              | (450,093)                      | 420,153                    |
| Amounts due from holding company and subsidiaries | 169,389              | —                     | 169,389              | —                              | 169,389                    |
| Gross of short positions                          | 1,423,468            | (383,833)             | 1,039,635            | (450,093)                      | 589,542                    |
| Short positions                                   | (14,074)             | —                     | (14,074)             | —                              | (14,074)                   |
| Net of short positions                            | 1,409,394            | (383,833)             | 1,025,561            | (450,093)                      | 575,468                    |
| <b>2011</b>                                       |                      |                       |                      |                                |                            |
| Cash and balances at central banks                | 64,261               | —                     | 64,261               | —                              | 64,261                     |
| Reverse repos                                     | 84,444               | (16,986)              | 67,458               | (9,867)                        | 57,591                     |
| Lending                                           | 187,976              | —                     | 187,976              | (33,252)                       | 154,724                    |
| Debt securities                                   | 111,313              | —                     | 111,313              | —                              | 111,313                    |
| Equity shares                                     | 10,486               | —                     | 10,486               | —                              | 10,486                     |
| Derivatives                                       | 1,062,576            | (543,736)             | 518,840              | (477,226)                      | 41,614                     |
| Settlement balances                               | 4,500                | (441)                 | 4,059                | (384)                          | 3,675                      |
| Total excluding disposal groups                   | 1,525,556            | (561,163)             | 964,393              | (520,729)                      | 443,664                    |
| Total including disposal groups                   | 1,544,175            | (561,163)             | 983,012              | (520,729)                      | 462,283                    |
| Amounts due from holding company and subsidiaries | 293,333              | —                     | 293,333              | —                              | 293,333                    |
| Gross of short positions                          | 1,837,508            | (561,163)             | 1,276,345            | (520,729)                      | 755,616                    |
| Short positions                                   | (24,858)             | —                     | (24,858)             | —                              | (24,858)                   |
| Net of short positions                            | 1,812,650            | (561,163)             | 1,251,487            | (520,729)                      | 730,758                    |

#### Notes:

- (1) Relates to offset arrangements that comply with IFRS criteria and to transactions cleared through and novated to central clearing houses, primarily London Clearing House and US Government Securities Clearing Corporation.
- (2) This reflects the amounts by which the Group's credit risk is reduced through master netting and cash management pooling arrangements. Derivative master netting agreements include cash pledged with counterparties in respect of net derivative liability positions and are included in lending in the table above.

## Financial review *Risk and balance sheet management*

### Sector and geographic concentration

The following tables analyse financial assets by sector and geography. Geographical regions are based on the location of the lending or issuer.

|                                                          | Group               |               |            |              |                   |                              |                           |                  | Exposure post offset<br>£m |
|----------------------------------------------------------|---------------------|---------------|------------|--------------|-------------------|------------------------------|---------------------------|------------------|----------------------------|
|                                                          | Reverse repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other financial assets<br>£m | Balance sheet value<br>£m | Offset (1)<br>£m |                            |
| 2013                                                     |                     |               | Debt<br>£m | Equity<br>£m |                   |                              |                           |                  |                            |
| Central and local government                             | 247                 | 7,976         | 64,993     | —            | 4,012             | 573                          | 77,801                    | (4,411)          | 73,390                     |
| Financial institutions - banks                           | 26,439              | 25,048        | 4,248      | 661          | 198,868           | 79,993                       | 335,257                   | (206,495)        | 128,762                    |
| - other (2)                                              | 49,156              | 34,875        | 29,135     | 2,185        | 69,391            | 4,855                        | 189,597                   | (87,075)         | 102,522                    |
| Personal - mortgages                                     | —                   | 148,111       | —          | —            | —                 | —                            | 148,111                   | —                | 148,111                    |
| - unsecured                                              | —                   | 28,096        | —          | —            | —                 | 3                            | 28,099                    | (3)              | 28,096                     |
| Property                                                 | —                   | 62,219        | 216        | 274          | 2,784             | —                            | 65,493                    | (689)            | 64,804                     |
| Construction                                             | —                   | 6,310         | 24         | 112          | 448               | 7                            | 6,901                     | (1,370)          | 5,531                      |
| Manufacturing                                            | 466                 | 20,613        | 701        | 2,154        | 1,209             | 43                           | 25,186                    | (2,526)          | 22,660                     |
| Finance leases and instalment credit                     | —                   | 13,503        | 14         | 5            | 13                | —                            | 13,535                    | (17)             | 13,518                     |
| Retail, wholesale and repairs                            | —                   | 19,330        | 244        | 438          | 881               | 11                           | 20,904                    | (1,962)          | 18,942                     |
| Transport and storage                                    | —                   | 16,427        | 299        | 72           | 2,085             | —                            | 18,883                    | (866)            | 18,017                     |
| Health, education and leisure                            | —                   | 16,080        | 103        | 85           | 656               | 14                           | 16,938                    | (853)            | 16,085                     |
| Hotels and restaurants                                   | —                   | 6,936         | 5          | 57           | 218               | —                            | 7,216                     | (165)            | 7,051                      |
| Utilities                                                | —                   | 4,810         | 176        | 284          | 3,194             | 23                           | 8,487                     | (1,064)          | 7,423                      |
| Other                                                    | 28                  | 27,280        | 577        | 2,050        | 2,231             | 51                           | 32,217                    | (2,777)          | 29,440                     |
| Total third party                                        | 76,336              | 437,614       | 100,735    | 8,377        | 285,990           | 85,573                       | 994,625                   | (310,273)        | 684,352                    |
| Amounts due from holding company and fellow subsidiaries | —                   | 16,678        | 101        | —            | 3,413             | 54                           | 20,246                    | (1,591)          | 18,655                     |
| Total gross of provisions                                | 76,336              | 454,292       | 100,836    | 8,377        | 289,403           | 85,627                       | 1,014,871                 | (311,864)        | 703,007                    |
| Provisions                                               | —                   | (25,045)      | (140)      | (99)         | —                 | —                            | (25,284)                  | n/a              | (25,284)                   |
| Total excluding disposal groups                          | 76,336              | 429,247       | 100,696    | 8,278        | 289,403           | 85,627                       | 989,587                   | (311,864)        | 677,723                    |
| Disposal groups                                          | —                   | 704           | —          | —            | 1                 | —                            | 705                       | —                | 705                        |
| Total including disposal groups                          | 76,336              | 429,951       | 100,696    | 8,278        | 289,404           | 85,627                       | 990,292                   | (311,864)        | 678,428                    |
| 2012                                                     |                     |               |            |              |                   |                              |                           |                  |                            |
| Central and local government                             | 441                 | 9,126         | 86,891     | —            | 5,746             | 589                          | 102,793                   | (5,142)          | 97,651                     |
| Financial institutions - banks                           | 34,444              | 25,862        | 5,203      | 1,469        | 334,323           | 74,524                       | 475,825                   | (340,372)        | 135,453                    |
| - other (2)                                              | 69,254              | 41,037        | 40,846     | 2,249        | 79,076            | 4,712                        | 237,174                   | (97,438)         | 139,736                    |
| Personal - mortgages                                     | —                   | 149,210       | —          | —            | —                 | —                            | 149,210                   | (1)              | 149,209                    |
| - unsecured                                              | —                   | 31,219        | —          | —            | —                 | 4                            | 31,223                    | (7)              | 31,216                     |
| Property                                                 | —                   | 72,109        | 661        | 313          | 4,056             | —                            | 77,139                    | (1,333)          | 75,806                     |
| Construction                                             | —                   | 8,010         | 17         | 257          | 799               | —                            | 9,083                     | (1,687)          | 7,396                      |
| Manufacturing                                            | 325                 | 21,928        | 173        | 1,545        | 1,606             | 144                          | 25,721                    | (3,775)          | 21,946                     |
| Finance leases and instalment credit                     | —                   | 13,520        | 49         | 1            | 4                 | —                            | 13,574                    | —                | 13,574                     |
| Retail, wholesale and repairs                            | —                   | 21,425        | 258        | 1,676        | 896               | 41                           | 24,296                    | (1,785)          | 22,511                     |
| Transport and storage                                    | —                   | 17,822        | 375        | 373          | 3,055             | 2                            | 21,627                    | (3,240)          | 18,387                     |
| Health, education and leisure                            | —                   | 16,685        | 224        | 552          | 891               | 59                           | 18,411                    | (964)            | 17,447                     |
| Hotels and restaurants                                   | —                   | 7,820         | 96         | 51           | 493               | 11                           | 8,471                     | (348)            | 8,123                      |
| Utilities                                                | —                   | 6,288         | 398        | 572          | 2,929             | 46                           | 10,233                    | (2,766)          | 7,467                      |
| Other                                                    | 23                  | 27,422        | 1,623      | 4,926        | 4,027             | 109                          | 38,130                    | (2,402)          | 35,728                     |
| Total third party                                        | 104,487             | 469,483       | 136,814    | 13,984       | 437,901           | 80,241                       | 1,242,910                 | (461,260)        | 781,650                    |
| Amounts due from holding company and fellow subsidiaries | —                   | 23,741        | 179        | —            | 7,200             | —                            | 31,120                    | —                | 31,120                     |
| Total gross of provisions                                | 104,487             | 493,224       | 136,993    | 13,984       | 445,101           | 80,241                       | 1,274,030                 | (461,260)        | 812,770                    |
| Provisions                                               | —                   | (20,807)      | (408)      | (112)        | —                 | —                            | (21,327)                  | n/a              | (21,327)                   |
| Total excluding disposal groups                          | 104,487             | 472,417       | 136,585    | 13,872       | 445,101           | 80,241                       | 1,252,703                 | (461,260)        | 791,443                    |
| Disposal groups                                          | —                   | 283           | —          | 5            | 3                 | 13                           | 304                       | —                | 304                        |
| Total including disposal groups                          | 104,487             | 472,700       | 136,585    | 13,877       | 445,104           | 80,254                       | 1,253,007                 | (461,260)        | 791,747                    |

For the notes to these tables refer to page 108.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis: Financial assets continued

|                                                             | Group                  |               |            |              |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
| 2011                                                        |                        |               | Debt<br>£m | Equity<br>£m |                   |                                 |                              |                  |                               |
| Central and local government                                | 2,247                  | 8,854         | 106,341    | —            | 5,455             | 549                             | 123,446                      | (1,098)          | 122,348                       |
| Financial institutions - banks                              | 37,760                 | 32,233        | —          | 1,448        | 400,322           | 68,487                          | 540,250                      | (407,009)        | 133,241                       |
| - other (2)                                                 | 58,233                 | 45,070        | 58,271     | 1,490        | 92,634            | 5,616                           | 261,314                      | (117,602)        | 143,712                       |
| Personal - mortgages                                        | —                      | 142,676       | —          | —            | —                 | —                               | 142,676                      | —                | 142,676                       |
| - unsecured                                                 | —                      | 31,481        | —          | —            | —                 | 7                               | 31,488                       | (7)              | 31,481                        |
| Property                                                    | —                      | 76,003        | 462        | 174          | 4,446             | 1                               | 81,086                       | (1,274)          | 79,812                        |
| Construction                                                | —                      | 8,681         | 50         | 29           | 905               | —                               | 9,665                        | (1,139)          | 8,526                         |
| Manufacturing                                               | 254                    | 22,065        | 446        | 1,921        | 3,317             | 306                             | 28,309                       | (2,214)          | 26,095                        |
| Finance leases and instalment credit                        | —                      | 14,414        | 127        | 2            | 73                | —                               | 14,616                       | (16)             | 14,600                        |
| Retail, wholesale and repairs                               | —                      | 20,175        | 366        | 2,406        | 1,045             | —                               | 23,992                       | (1,671)          | 22,321                        |
| Transport and storage                                       | 436                    | 20,251        | 207        | 68           | 3,382             | —                               | 24,344                       | (206)            | 24,138                        |
| Health, education and leisure                               | —                      | 14,542        | 119        | 13           | 871               | —                               | 15,545                       | (973)            | 14,572                        |
| Hotels and restaurants                                      | —                      | 8,229         | 107        | 3            | 669               | —                               | 9,008                        | (184)            | 8,824                         |
| Utilities                                                   | —                      | 6,586         | 608        | 285          | 3,266             | —                               | 10,745                       | (450)            | 10,295                        |
| Other                                                       | 87                     | 26,792        | 1,821      | 4,064        | 6,042             | 455                             | 39,261                       | (1,002)          | 38,259                        |
| Total third party                                           | 99,017                 | 478,052       | 168,925    | 11,903       | 522,427           | 75,421                          | 1,355,745                    | (534,845)        | 820,900                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 28,024        | 802        | —            | 10,380            | —                               | 39,206                       | —                | 39,206                        |
| Total gross of provisions                                   | 99,017                 | 506,076       | 169,727    | 11,903       | 532,807           | 75,421                          | 1,394,951                    | (534,845)        | 860,106                       |
| Provisions                                                  | —                      | (18,554)      | (586)      | (141)        | —                 | —                               | (19,281)                     | n/a              | (19,281)                      |
| Total excluding disposal groups                             | 99,017                 | 487,522       | 169,141    | 11,762       | 532,807           | 75,421                          | 1,375,670                    | (534,845)        | 840,825                       |
| Disposal groups                                             | —                      | 18,748        | —          | 5            | 439               | 132                             | 19,324                       | —                | 19,324                        |
| Total including disposal groups                             | 99,017                 | 506,270       | 169,141    | 11,767       | 533,246           | 75,553                          | 1,394,994                    | (534,845)        | 860,149                       |

|                                                      | Bank                   |               |            |              |                   |                                 |                              |                  |                               |
|------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                      | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
| 2013                                                 |                        |               | Debt<br>£m | Equity<br>£m |                   |                                 |                              |                  |                               |
| Central and local government                         | —                      | 6,110         | 47,879     | —            | 3,986             | 128                             | 58,103                       | (3,191)          | 54,912                        |
| Financial institutions - banks                       | 19,111                 | 17,609        | 3,655      | 495          | 198,813           | 75,792                          | 315,475                      | (206,495)        | 108,980                       |
| - other (2)                                          | 24,159                 | 27,754        | 12,699     | 1,635        | 68,781            | 3,010                           | 138,038                      | (81,662)         | 56,376                        |
| Personal - mortgages                                 | —                      | 35,925        | —          | —            | —                 | —                               | 35,925                       | —                | 35,925                        |
| - unsecured                                          | —                      | 4,326         | —          | —            | —                 | —                               | 4,326                        | (3)              | 4,323                         |
| Property                                             | —                      | 25,971        | 374        | 207          | 2,422             | —                               | 28,974                       | (422)            | 28,552                        |
| Construction                                         | —                      | 2,804         | 22         | 104          | 440               | —                               | 3,370                        | (272)            | 3,098                         |
| Manufacturing                                        | 466                    | 10,462        | 347        | 2,152        | 1,153             | 24                              | 14,604                       | (1,728)          | 12,876                        |
| Finance leases and instalment credit                 | —                      | 186           | 6          | 4            | 13                | —                               | 209                          | (3)              | 206                           |
| Retail, wholesale and repairs                        | —                      | 6,031         | 157        | 438          | 754               | —                               | 7,380                        | (603)            | 6,777                         |
| Transport and storage                                | —                      | 13,160        | 223        | 64           | 2,055             | —                               | 15,502                       | (639)            | 14,863                        |
| Health, education and leisure                        | —                      | 5,945         | 39         | 83           | 477               | —                               | 6,544                        | (248)            | 6,296                         |
| Hotels and restaurants                               | —                      | 2,846         | 1          | 50           | 176               | —                               | 3,073                        | (81)             | 2,992                         |
| Utilities                                            | —                      | 3,435         | 138        | 282          | 3,113             | 23                              | 6,991                        | (774)            | 6,217                         |
| Other                                                | 26                     | 11,997        | 84         | 1,810        | 1,730             | 17                              | 15,664                       | (1,398)          | 14,266                        |
| Total third party                                    | 43,762                 | 174,561       | 65,624     | 7,324        | 283,913           | 78,994                          | 654,178                      | (297,519)        | 356,659                       |
| Amounts due from holding company<br>and subsidiaries | —                      | 91,055        | 26,843     | —            | 8,967             | 290                             | 127,155                      | (3,870)          | 123,285                       |
| Total gross of provisions                            | 43,762                 | 265,616       | 92,467     | 7,324        | 292,880           | 79,284                          | 781,333                      | (301,389)        | 479,944                       |
| Provisions                                           | —                      | (6,236)       | (140)      | (23)         | —                 | —                               | (6,399)                      | n/a              | (6,399)                       |
| Total                                                | 43,762                 | 259,380       | 92,327     | 7,301        | 292,880           | 79,284                          | 774,934                      | (301,389)        | 473,545                       |

For the notes to these tables refer to page 108.

## Financial review *Risk and balance sheet management*

|                                                      | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Bank<br>Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|------------------------------------------------------|------------------------|---------------|------------|--------------|---------------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                      |                        |               | Debt<br>£m | Equity<br>£m |                           |                                 |                              |                  |                               |
| 2012                                                 |                        |               |            |              |                           |                                 |                              |                  |                               |
| Central and local government                         | 441                    | 7,317         | 66,740     | —            | 5,723                     | 89                              | 80,310                       | (4,498)          | 75,812                        |
| Financial institutions - banks                       | 25,594                 | 18,414        | 4,710      | 1,151        | 334,278                   | 70,374                          | 454,521                      | (340,372)        | 114,149                       |
| - other (2)                                          | 42,210                 | 30,452        | 16,343     | 2,555        | 78,317                    | 2,700                           | 172,577                      | (93,867)         | 78,710                        |
| Personal - mortgages                                 | —                      | 39,299        | —          | —            | —                         | —                               | 39,299                       | —                | 39,299                        |
| - unsecured                                          | —                      | 4,706         | —          | —            | —                         | —                               | 4,706                        | (5)              | 4,701                         |
| Property                                             | —                      | 31,905        | 315        | 235          | 3,375                     | —                               | 35,830                       | (514)            | 35,316                        |
| Construction                                         | —                      | 4,009         | 14         | 256          | 782                       | —                               | 5,061                        | (608)            | 4,453                         |
| Manufacturing                                        | 325                    | 11,006        | 19         | 1,530        | 1,529                     | 95                              | 14,504                       | (2,327)          | 12,177                        |
| Finance leases and instalment credit                 | —                      | 278           | 49         | —            | 4                         | —                               | 331                          | —                | 331                           |
| Retail, wholesale and repairs                        | —                      | 7,476         | 200        | 1,675        | 805                       | 40                              | 10,196                       | (558)            | 9,638                         |
| Transport and storage                                | —                      | 14,061        | 220        | 373          | 3,017                     | 2                               | 17,673                       | (2,836)          | 14,837                        |
| Health, education and leisure                        | —                      | 6,575         | 56         | 552          | 609                       | 28                              | 7,820                        | (264)            | 7,556                         |
| Hotels and restaurants                               | —                      | 3,196         | 73         | 51           | 421                       | 11                              | 3,752                        | (223)            | 3,529                         |
| Utilities                                            | —                      | 4,496         | 295        | 556          | 2,838                     | 39                              | 8,224                        | (2,231)          | 5,993                         |
| Other                                                | 19                     | 13,828        | 523        | 3,855        | 3,187                     | 86                              | 21,498                       | (1,790)          | 19,708                        |
| Total third-party                                    | 68,589                 | 197,018       | 89,557     | 12,789       | 434,885                   | 73,464                          | 876,302                      | (450,093)        | 426,209                       |
| Amounts due from holding<br>company and subsidiaries | —                      | 121,139       | 33,297     | —            | 14,953                    | —                               | 169,389                      | —                | 169,389                       |
| Total gross of provisions                            | 68,589                 | 318,157       | 122,854    | 12,789       | 449,838                   | 73,464                          | 1,045,691                    | (450,093)        | 595,598                       |
| Provisions                                           | —                      | (5,626)       | (407)      | (23)         | —                         | —                               | (6,056)                      | n/a              | (6,056)                       |
| Total                                                | 68,589                 | 312,531       | 122,447    | 12,766       | 449,838                   | 73,464                          | 1,039,635                    | (450,093)        | 589,542                       |
| 2011                                                 |                        |               |            |              |                           |                                 |                              |                  |                               |
| Central and local government                         | 2,247                  | 6,368         | 82,888     | —            | 5,410                     | 548                             | 97,461                       | (478)            | 96,983                        |
| Financial institutions - banks                       | 25,410                 | 24,735        | —          | 1,092        | 393,516                   | 64,261                          | 509,014                      | (382,395)        | 126,619                       |
| - other (2)                                          | 39,037                 | 27,483        | 25,443     | 943          | 98,426                    | 2,829                           | 194,161                      | (135,796)        | 58,365                        |
| Personal - mortgages                                 | —                      | 36,088        | —          | —            | —                         | —                               | 36,088                       | —                | 36,088                        |
| - unsecured                                          | —                      | 3,338         | —          | —            | —                         | —                               | 3,338                        | (7)              | 3,331                         |
| Property                                             | —                      | 31,888        | 1,106      | 101          | 3,637                     | 1                               | 36,733                       | (360)            | 36,373                        |
| Construction                                         | —                      | 3,783         | 21         | 28           | 856                       | —                               | 4,688                        | (173)            | 4,515                         |
| Manufacturing                                        | 254                    | 11,221        | 340        | 1,918        | 3,223                     | 306                             | 17,262                       | (734)            | 16,528                        |
| Finance leases and instalment credit                 | —                      | 172           | 127        | —            | 73                        | —                               | 372                          | (16)             | 356                           |
| Retail, wholesale and repairs                        | —                      | 5,362         | 311        | 2,403        | 936                       | —                               | 9,012                        | (268)            | 8,744                         |
| Transport and storage                                | 436                    | 16,165        | 128        | 68           | 3,343                     | —                               | 20,140                       | (38)             | 20,102                        |
| Health, education and leisure                        | —                      | 4,502         | 45         | —            | 576                       | —                               | 5,123                        | (166)            | 4,957                         |
| Hotels and restaurants                               | —                      | 3,389         | 14         | 2            | 585                       | —                               | 3,990                        | (69)             | 3,921                         |
| Utilities                                            | —                      | 4,568         | 328        | 265          | 3,172                     | —                               | 8,333                        | (13)             | 8,320                         |
| Other                                                | 74                     | 13,537        | 1,134      | 3,718        | 5,087                     | 375                             | 23,925                       | (216)            | 23,709                        |
| Total third party                                    | 67,458                 | 192,599       | 111,885    | 10,538       | 518,840                   | 68,320                          | 969,640                      | (520,729)        | 448,911                       |
| Amounts due from holding<br>company and subsidiaries | —                      | 204,729       | 70,147     | —            | 18,457                    | —                               | 293,333                      | —                | 293,333                       |
| Total gross of provisions                            | 67,458                 | 397,328       | 182,032    | 10,538       | 537,297                   | 68,320                          | 1,262,973                    | (520,729)        | 742,244                       |
| Provisions                                           | —                      | (4,623)       | (572)      | (52)         | —                         | —                               | (5,247)                      | n/a              | (5,247)                       |
| Total excluding disposal groups                      | 67,458                 | 392,705       | 181,460    | 10,486       | 537,297                   | 68,320                          | 1,257,726                    | (520,729)        | 736,997                       |
| Disposal groups                                      | —                      | 18,111        | —          | —            | 414                       | 94                              | 18,619                       | —                | 18,619                        |
| Total including disposal groups                      | 67,458                 | 410,816       | 181,460    | 10,486       | 537,711                   | 68,414                          | 1,276,345                    | (520,729)        | 755,616                       |

For the notes to these tables refer to page 108.

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## Financial review *Risk and balance sheet management*

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### Balance sheet analysis: Financial assets continued

#### Key points

- Financial asset exposures after offset decreased by £113.3 billion or 14% to £678.4 billion in the year, reflecting the Group's focus on reducing its funded balance sheet primarily through ongoing sales in Non-Core and downsizing of Markets.
- Reductions across securities (debt - £35.9 billion; equity - £5.6 billion), lending (£42.7 billion) reverse repos (£28.2 billion) and derivatives (£155.7 billion) were partially offset by higher cash holdings (£5.5 billion). Conditions in the financial markets and the Group's continued focus on risk appetite and sector concentrations resulted in the trends seen.
- Exposures to central and local government decreased by £24.3 billion principally in debt securities. This was driven by Markets de-risking its balance sheet, management of the Group Treasury liquidity portfolio as well as some risk reduction in respect of Eurozone exposures
- Exposure to financial institutions was £47.7 billion lower across reverse repos, lending, securities and derivatives. This was driven by economy-wide subdued activity being partially offset by a £5.5 billion increase in cash holdings.
- The banking sector continues to be one of the largest in the Group's portfolio. The sector is well diversified geographically and by exposure with derivative exposures being largely collateralised. The sector continues to be tightly controlled through the combination of the single name concentration framework, bespoke credit policies and country limits. Exposures to the banking sector decreased by £6.7 billion during the year, with decreases across, reverse repos lending, securities and derivatives being partially offset by increased cash holdings with central banks.
- Exposure to other financial institutions comprising traded and non-traded products is spread across a wide range of financial companies including insurance, securitisation vehicles, financial intermediaries including broker dealers and central counterparties (CCPs), financial guarantors - monolines and CDPCs - and funds comprising unleveraged, hedge and leveraged funds. The size of the portfolio decreased by £37.2 billion. Entities in this sector remain vulnerable to market shocks or contagion from the banking sector.
- The Group's exposure to property and construction sector decreased by £12.9 billion, principally in commercial real estate lending. The majority of the Group's Core property exposure is within UK Corporate (72%).
- Retail, wholesale and repairs sector decreased by £3.6 billion, reflecting the Group's strategy to re-balance the Core portfolios towards stronger customers in the sector while at the same time continuing to reduce the Non-Core book.
- Transport and storage exposure decreased by £0.4 billion. The sector includes asset-backed exposures to ocean-going vessels. Conditions remain poor across the major shipping market segments in 2013 with low charter rates and vessel values. At 31 December 2013 £1.1 billion (2012 - £0.7 billion) of loans were included in risk elements in lending with an associated provision of £0.4 billion and impairment charge of £0.4 billion for 2013.
- Within lending:
  - UK Retail unsecured lending decreased by £0.6 billion, partially offset by an increase of £0.2 billion in mortgage lending.
  - UK Corporate lending decreased by £4.5 billion, as business demand for credit remains weak.
  - Non-Core continued to make significant progress on its balance sheet strategy by reducing lending by £17.2 billion across all sectors, principally property and construction, where commercial real estate lending decreased by £7.1 billion.

## Financial review *Risk and balance sheet management*

The tables on pages 103 to 114 analyse financial assets by geographical region (location of office) and sector.

| 2013                                                        | Group                  |               |            |              |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|                                                             | £m                     | £m            | Debt<br>£m | Equity<br>£m | £m                | £m                              | £m                           | £m               | £m                            |
| <b>UK</b>                                                   |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 6,934         | 13,210     | —            | 3,819             | 122                             | 24,085                       | (4,329)          | 19,756                        |
| Financial institutions - banks                              | 18,448                 | 16,932        | 2,725      | 422          | 131,318           | 55,718                          | 225,563                      | (141,310)        | 84,253                        |
| - other (2)                                                 | 19,290                 | 28,275        | 11,773     | 1,706        | 56,041            | 2,245                           | 119,330                      | (69,855)         | 49,475                        |
| Personal - mortgages                                        | —                      | 110,515       | —          | —            | —                 | —                               | 110,515                      | —                | 110,515                       |
| - unsecured                                                 | —                      | 17,098        | —          | —            | —                 | 3                               | 17,101                       | (3)              | 17,098                        |
| Property                                                    | —                      | 44,232        | 77         | 240          | 2,718             | —                               | 47,267                       | (676)            | 46,591                        |
| Construction                                                | —                      | 4,691         | 22         | 98           | 414               | 7                               | 5,232                        | (1,346)          | 3,886                         |
| Manufacturing                                               | 466                    | 8,740         | 400        | 2,136        | 979               | 21                              | 12,742                       | (2,415)          | 10,327                        |
| Finance leases and instalment credit                        | —                      | 10,567        | 3          | 5            | 11                | —                               | 10,586                       | (16)             | 10,570                        |
| Retail, wholesale and repairs                               | —                      | 10,803        | 154        | 423          | 724               | 11                              | 12,115                       | (1,908)          | 10,207                        |
| Transport and storage                                       | —                      | 8,918         | 141        | 63           | 1,643             | —                               | 10,765                       | (703)            | 10,062                        |
| Health, education and leisure                               | —                      | 11,757        | 39         | 79           | 614               | 14                              | 12,503                       | (847)            | 11,656                        |
| Hotels and restaurants                                      | —                      | 5,333         | 1          | 50           | 217               | —                               | 5,601                        | (161)            | 5,440                         |
| Utilities                                                   | —                      | 2,117         | 123        | 280          | 2,869             | —                               | 5,389                        | (1,027)          | 4,362                         |
| Other                                                       | 18                     | 16,030        | 73         | 1,963        | 1,469             | 48                              | 19,601                       | (2,626)          | 16,975                        |
| Total third party                                           | 38,222                 | 302,942       | 28,741     | 7,465        | 202,836           | 58,189                          | 638,395                      | (227,222)        | 411,173                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 15,007        | 101        | —            | 2,825             | 5                               | 17,938                       | (1,591)          | 16,347                        |
| Total gross of provisions                                   | 38,222                 | 317,949       | 28,842     | 7,465        | 205,661           | 58,194                          | 656,333                      | (228,813)        | 427,520                       |
| Provisions                                                  | —                      | (10,990)      | (90)       | (99)         | —                 | —                               | (11,179)                     | n/a              | (11,179)                      |
| Total                                                       | 38,222                 | 306,959       | 28,752     | 7,366        | 205,661           | 58,194                          | 645,154                      | (228,813)        | 416,341                       |
| <b>US</b>                                                   |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | 247                    | 238           | 22,402     | —            | 21                | 221                             | 23,129                       | (12)             | 23,117                        |
| Financial institutions - banks                              | 4,073                  | 922           | 216        | 166          | 53,159            | 16,979                          | 75,515                       | (53,339)         | 22,176                        |
| - other (2)                                                 | 18,346                 | 3,892         | 17,263     | 379          | 9,579             | 2,276                           | 51,735                       | (13,778)         | 37,957                        |
| Personal - mortgages                                        | —                      | 19,665        | —          | —            | —                 | —                               | 19,665                       | —                | 19,665                        |
| - unsecured                                                 | —                      | 8,666         | —          | —            | —                 | —                               | 8,666                        | —                | 8,666                         |
| Property                                                    | —                      | 4,249         | —          | —            | 21                | —                               | 4,270                        | (7)              | 4,263                         |
| Construction                                                | —                      | 313           | 2          | 13           | 2                 | —                               | 330                          | —                | 330                           |
| Manufacturing                                               | —                      | 6,117         | 299        | 9            | 128               | —                               | 6,553                        | (56)             | 6,497                         |
| Finance leases and instalment credit                        | —                      | 2,513         | 8          | —            | 1                 | —                               | 2,522                        | —                | 2,522                         |
| Retail, wholesale and repairs                               | —                      | 4,914         | 87         | 1            | 32                | —                               | 5,034                        | (6)              | 5,028                         |
| Transport and storage                                       | —                      | 1,649         | 76         | 7            | 370               | —                               | 2,102                        | (141)            | 1,961                         |
| Health, education and leisure                               | —                      | 3,059         | 55         | 2            | 37                | —                               | 3,153                        | —                | 3,153                         |
| Hotels and restaurants                                      | —                      | 369           | 4          | 7            | 1                 | —                               | 381                          | —                | 381                           |
| Utilities                                                   | —                      | 638           | 32         | 1            | 149               | —                               | 820                          | (27)             | 793                           |
| Other                                                       | 10                     | 4,124         | 422        | 16           | 538               | —                               | 5,110                        | (20)             | 5,090                         |
| Total third party                                           | 22,676                 | 61,328        | 40,866     | 601          | 64,038            | 19,476                          | 208,985                      | (67,386)         | 141,599                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 345           | —          | —            | 343               | —                               | 688                          | —                | 688                           |
| Total gross of provisions                                   | 22,676                 | 61,673        | 40,866     | 601          | 64,381            | 19,476                          | 209,673                      | (67,386)         | 142,287                       |
| Provisions                                                  | —                      | (840)         | (15)       | —            | —                 | —                               | (855)                        | n/a              | (855)                         |
| Total excluding disposal groups                             | 22,676                 | 60,833        | 40,851     | 601          | 64,381            | 19,476                          | 208,818                      | (67,386)         | 141,432                       |
| Disposal groups                                             | —                      | 677           | —          | —            | 1                 | —                               | 678                          | —                | 678                           |
| Total including disposal groups                             | 22,676                 | 61,510        | 40,851     | 601          | 64,382            | 19,476                          | 209,496                      | (67,386)         | 142,110                       |

For the notes to this table refer to page 108.



## Financial review *Risk and balance sheet management*

### Balance sheet analysis: Financial assets continued

| 2013                                                     | Group   |          |            |        |             |       |          |            |          |
|----------------------------------------------------------|---------|----------|------------|--------|-------------|-------|----------|------------|----------|
|                                                          | Reverse | Lending  | Securities |        | Derivatives | Other | Balance  | Offset (1) | Exposure |
|                                                          | repos   |          | Debt       | Equity |             |       |          |            |          |
|                                                          | £m      | £m       | £m         | £m     | £m          | £m    | £m       | £m         | £m       |
| Europe                                                   |         |          |            |        |             |       |          |            |          |
| Central and local government                             | —       | 734      | 25,931     | —      | 53          | —     | 26,718   | —          | 26,718   |
| Financial institutions - banks                           | 658     | 1,557    | 710        | 1      | 39          | 5,590 | 8,555    | —          | 8,555    |
| - other (2)                                              | —       | 1,305    | 29         | 50     | 46          | 3     | 1,433    | —          | 1,433    |
| Personal - mortgages                                     | —       | 17,354   | —          | —      | —           | —     | 17,354   | —          | 17,354   |
| - unsecured                                              | —       | 1,267    | —          | —      | —           | —     | 1,267    | —          | 1,267    |
| Property                                                 | —       | 13,174   | —          | 31     | 25          | —     | 13,230   | (5)        | 13,225   |
| Construction                                             | —       | 977      | —          | —      | —           | —     | 977      | (20)       | 957      |
| Manufacturing                                            | —       | 3,596    | —          | 3      | 26          | 22    | 3,647    | (9)        | 3,638    |
| Finance leases and instalment credit                     | —       | 378      | —          | —      | —           | —     | 378      | —          | 378      |
| Retail, wholesale and repairs                            | —       | 2,826    | —          | —      | 27          | —     | 2,853    | (21)       | 2,832    |
| Transport and storage                                    | —       | 5,219    | —          | —      | 16          | —     | 5,235    | (5)        | 5,230    |
| Health, education and leisure                            | —       | 1,078    | 9          | —      | 2           | —     | 1,089    | (6)        | 1,083    |
| Hotels and restaurants                                   | —       | 1,180    | —          | —      | —           | —     | 1,180    | (4)        | 1,176    |
| Utilities                                                | —       | 1,594    | 6          | —      | 40          | —     | 1,640    | —          | 1,640    |
| Other                                                    | —       | 4,267    | —          | 3      | 31          | —     | 4,301    | (52)       | 4,249    |
| Total third party                                        | 658     | 56,506   | 26,685     | 88     | 305         | 5,615 | 89,857   | (122)      | 89,735   |
| Amounts due from holding company and fellow subsidiaries | —       | 830      | —          | —      | 79          | 49    | 958      | —          | 958      |
| Total gross of provisions                                | 658     | 57,336   | 26,685     | 88     | 384         | 5,664 | 90,815   | (122)      | 90,693   |
| Provisions                                               | —       | (13,016) | —          | —      | —           | —     | (13,016) | n/a        | (13,016) |
| Total excluding disposal groups                          | 658     | 44,320   | 26,685     | 88     | 384         | 5,664 | 77,799   | (122)      | 77,677   |
| Disposal groups                                          | —       | 27       | —          | —      | —           | —     | 27       | —          | 27       |
| Total including disposal groups                          | 658     | 44,347   | 26,685     | 88     | 384         | 5,664 | 77,826   | (122)      | 77,704   |
| RoW                                                      |         |          |            |        |             |       |          |            |          |
| Central and local government                             | —       | 70       | 3,450      | —      | 119         | 230   | 3,869    | (70)       | 3,799    |
| Financial institutions - banks                           | 3,260   | 5,637    | 597        | 72     | 14,352      | 1,706 | 25,624   | (11,846)   | 13,778   |
| - other (2)                                              | 11,520  | 1,403    | 70         | 50     | 3,725       | 331   | 17,099   | (3,442)    | 13,657   |
| Personal - mortgages                                     | —       | 577      | —          | —      | —           | —     | 577      | —          | 577      |
| - unsecured                                              | —       | 1,065    | —          | —      | —           | —     | 1,065    | —          | 1,065    |
| Property                                                 | —       | 564      | 139        | 3      | 20          | —     | 726      | (1)        | 725      |
| Construction                                             | —       | 329      | —          | 1      | 32          | —     | 362      | (4)        | 358      |
| Manufacturing                                            | —       | 2,160    | 2          | 6      | 76          | —     | 2,244    | (46)       | 2,198    |
| Finance leases and instalment credit                     | —       | 45       | 3          | —      | 1           | —     | 49       | (1)        | 48       |
| Retail, wholesale and repairs                            | —       | 787      | 3          | 14     | 98          | —     | 902      | (27)       | 875      |
| Transport and storage                                    | —       | 641      | 82         | 2      | 56          | —     | 781      | (17)       | 764      |
| Health, education and leisure                            | —       | 186      | —          | 4      | 3           | —     | 193      | —          | 193      |
| Hotels and restaurants                                   | —       | 54       | —          | —      | —           | —     | 54       | —          | 54       |
| Utilities                                                | —       | 461      | 15         | 3      | 136         | 23    | 638      | (10)       | 628      |
| Other                                                    | —       | 2,859    | 82         | 68     | 193         | 3     | 3,205    | (79)       | 3,126    |
| Total third party                                        | 14,780  | 16,838   | 4,443      | 223    | 18,811      | 2,293 | 57,388   | (15,543)   | 41,845   |
| Amounts due from holding company and fellow subsidiaries | —       | 496      | —          | —      | 166         | —     | 662      | —          | 662      |
| Total gross of provisions                                | 14,780  | 17,334   | 4,443      | 223    | 18,977      | 2,293 | 58,050   | (15,543)   | 42,507   |
| Provisions                                               | —       | (199)    | (35)       | —      | —           | —     | (234)    | n/a        | (234)    |
| Total                                                    | 14,780  | 17,135   | 4,408      | 223    | 18,977      | 2,293 | 57,816   | (15,543)   | 42,273   |

For the notes to this table refer to page 108.

## Financial review *Risk and balance sheet management*

|                                                             | Group                  |               |            |        |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------|--------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities |        | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
| 2012                                                        | £m                     | £m            | £m         | £m     | £m                | £m                              | £m                           | £m               | £m                            |
| <b>UK</b>                                                   |                        |               |            |        |                   |                                 |                              |                  |                               |
| Central and local government                                | 441                    | 8,060         | 60,827     | —      | 5,537             | 47                              | 74,912                       | (5,019)          | 69,893                        |
| Financial institutions - banks                              | 24,851                 | 19,637        | 4,029      | 1,038  | 193,886           | 41,008                          | 284,449                      | (201,458)        | 82,991                        |
| - other (2)                                                 | 42,200                 | 33,164        | 14,906     | 1,844  | 61,248            | 2,022                           | 155,384                      | (78,825)         | 76,559                        |
| Personal - mortgages                                        | —                      | 109,530       | —          | —      | —                 | —                               | 109,530                      | —                | 109,530                       |
| - unsecured                                                 | —                      | 19,691        | —          | —      | —                 | 4                               | 19,695                       | (7)              | 19,688                        |
| Property                                                    | —                      | 53,704        | 434        | 282    | 3,903             | —                               | 58,323                       | (1,328)          | 56,995                        |
| Construction                                                | —                      | 6,507         | 14         | 248    | 786               | —                               | 7,555                        | (1,666)          | 5,889                         |
| Manufacturing                                               | 325                    | 10,036        | 12         | 1,498  | 1,274             | 111                             | 13,256                       | (3,542)          | 9,714                         |
| Finance leases and instalment credit                        | —                      | 10,532        | 49         | 1      | —                 | —                               | 10,582                       | —                | 10,582                        |
| Retail, wholesale and repairs                               | —                      | 11,509        | 194        | 1,551  | 701               | 41                              | 13,996                       | (1,590)          | 12,406                        |
| Transport and storage                                       | —                      | 10,358        | 244        | 361    | 2,019             | 2                               | 12,984                       | (2,279)          | 10,705                        |
| Health, education and leisure                               | —                      | 11,901        | 56         | 548    | 806               | 59                              | 13,370                       | (888)            | 12,482                        |
| Hotels and restaurants                                      | —                      | 5,989         | 73         | 51     | 493               | 11                              | 6,617                        | (344)            | 6,273                         |
| Utilities                                                   | —                      | 3,556         | 282        | 441    | 2,553             | 26                              | 6,858                        | (2,515)          | 4,343                         |
| Other                                                       | 19                     | 15,703        | 912        | 4,369  | 2,602             | 109                             | 23,714                       | (1,885)          | 21,829                        |
| Total third party                                           | 67,836                 | 329,877       | 82,032     | 12,232 | 275,808           | 43,440                          | 811,225                      | (301,346)        | 509,879                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 20,971        | 179        | —      | 2,837             | —                               | 23,987                       | —                | 23,987                        |
| Total gross of provisions                                   | 67,836                 | 350,848       | 82,211     | 12,232 | 278,645           | 43,440                          | 835,212                      | (301,346)        | 533,866                       |
| Provisions                                                  | —                      | (9,746)       | (261)      | (112)  | —                 | —                               | (10,119)                     | n/a              | (10,119)                      |
| Total                                                       | 67,836                 | 341,102       | 81,950     | 12,120 | 278,645           | 43,440                          | 825,093                      | (301,346)        | 523,747                       |
| <b>US</b>                                                   |                        |               |            |        |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 151           | 19,995     | —      | 23                | 500                             | 20,669                       | (17)             | 20,652                        |
| Financial institutions - banks                              | 5,024                  | 1,230         | 421        | 349    | 116,711           | 11,315                          | 135,050                      | (115,459)        | 19,591                        |
| - other (2)                                                 | 22,808                 | 4,209         | 25,457     | 202    | 13,366            | 2,238                           | 68,280                       | (14,720)         | 53,560                        |
| Personal - mortgages                                        | —                      | 21,911        | —          | —      | —                 | —                               | 21,911                       | —                | 21,911                        |
| - unsecured                                                 | —                      | 8,748         | —          | —      | —                 | —                               | 8,748                        | —                | 8,748                         |
| Property                                                    | —                      | 3,343         | 8          | 26     | 34                | —                               | 3,411                        | —                | 3,411                         |
| Construction                                                | —                      | 388           | 3          | 2      | 9                 | —                               | 402                          | —                | 402                           |
| Manufacturing                                               | —                      | 6,011         | 154        | 15     | 217               | —                               | 6,397                        | (215)            | 6,182                         |
| Finance leases and instalment credit                        | —                      | 2,471         | —          | —      | —                 | —                               | 2,471                        | —                | 2,471                         |
| Retail, wholesale and repairs                               | —                      | 4,891         | 58         | 1      | 66                | —                               | 5,016                        | (52)             | 4,964                         |
| Transport and storage                                       | —                      | 1,916         | 37         | —      | 855               | —                               | 2,808                        | (800)            | 2,008                         |
| Health, education and leisure                               | —                      | 2,848         | 168        | —      | 73                | —                               | 3,089                        | (70)             | 3,019                         |
| Hotels and restaurants                                      | —                      | 490           | 23         | —      | —                 | —                               | 513                          | —                | 513                           |
| Utilities                                                   | —                      | 956           | 96         | 15     | 258               | —                               | 1,325                        | (251)            | 1,074                         |
| Other                                                       | 4                      | 5,016         | 665        | 324    | 1,045             | —                               | 7,054                        | (277)            | 6,777                         |
| Total third party                                           | 27,836                 | 64,579        | 47,085     | 934    | 132,657           | 14,053                          | 287,144                      | (131,861)        | 155,283                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 130           | —          | —      | 1,938             | —                               | 2,068                        | —                | 2,068                         |
| Total gross of provisions                                   | 27,836                 | 64,709        | 47,085     | 934    | 134,595           | 14,053                          | 289,212                      | (131,861)        | 157,351                       |
| Provisions                                                  | —                      | (865)         | (45)       | —      | —                 | —                               | (910)                        | n/a              | (910)                         |
| Total excluding disposal groups                             | 27,836                 | 63,844        | 47,040     | 934    | 134,595           | 14,053                          | 288,302                      | (131,861)        | 156,441                       |
| Disposal groups                                             | —                      | 283           | —          | 5      | 3                 | 13                              | 304                          | —                | 304                           |
| Total including disposal groups                             | 27,836                 | 64,127        | 47,040     | 939    | 134,598           | 14,066                          | 288,606                      | (131,861)        | 156,745                       |

For the notes to this table refer to page 108.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis: Financial assets continued

|                                                             | Group                  |               |                                          |     |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------------------------------------|-----|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities<br>Debt<br>Equity<br>£m<br>£m |     | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
| 2012                                                        |                        |               |                                          |     |                   |                                 |                              |                  |                               |
| Europe                                                      |                        |               |                                          |     |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 843           | 795                                      | —   | 54                | —                               | 1,692                        | (15)             | 1,677                         |
| Financial institutions - banks                              | 375                    | 1,733         | 100                                      | —   | 21                | 21,323                          | 23,552                       | (2)              | 23,550                        |
| - other (2)                                                 | 20                     | 1,536         | —                                        | 145 | 93                | 26                              | 1,820                        | —                | 1,820                         |
| Personal - mortgages                                        | —                      | 17,451        | —                                        | —   | —                 | —                               | 17,451                       | (1)              | 17,450                        |
| - unsecured                                                 | —                      | 1,727         | —                                        | —   | —                 | —                               | 1,727                        | —                | 1,727                         |
| Property                                                    | —                      | 14,571        | —                                        | 2   | 77                | —                               | 14,650                       | (5)              | 14,645                        |
| Construction                                                | —                      | 1,109         | —                                        | 6   | —                 | —                               | 1,115                        | (21)             | 1,094                         |
| Manufacturing                                               | —                      | 4,686         | —                                        | 26  | 24                | 1                               | 4,737                        | (9)              | 4,728                         |
| Finance leases and instalment credit                        | —                      | 453           | —                                        | —   | —                 | —                               | 453                          | —                | 453                           |
| Retail, wholesale and repairs                               | —                      | 3,442         | —                                        | 109 | 7                 | —                               | 3,558                        | (22)             | 3,536                         |
| Transport and storage                                       | —                      | 5,209         | —                                        | 10  | 12                | —                               | 5,231                        | (5)              | 5,226                         |
| Health, education and leisure                               | —                      | 1,551         | —                                        | —   | —                 | —                               | 1,551                        | (6)              | 1,545                         |
| Hotels and restaurants                                      | —                      | 1,326         | —                                        | —   | —                 | —                               | 1,326                        | (4)              | 1,322                         |
| Utilities                                                   | —                      | 1,342         | 6                                        | 112 | 47                | 20                              | 1,527                        | —                | 1,527                         |
| Other                                                       | —                      | 4,711         | 1                                        | 165 | 38                | —                               | 4,915                        | (52)             | 4,863                         |
| Total third party                                           | 395                    | 61,690        | 902                                      | 575 | 373               | 21,370                          | 85,305                       | (142)            | 85,163                        |
| Amounts due from holding<br>company and fellow subsidiaries | —                      | 534           | —                                        | —   | 380               | —                               | 914                          | —                | 914                           |
| Total gross of provisions                                   | 395                    | 62,224        | 902                                      | 575 | 753               | 21,370                          | 86,219                       | (142)            | 86,077                        |
| Provisions                                                  | —                      | (10,010)      | —                                        | —   | —                 | —                               | (10,010)                     | n/a              | (10,010)                      |
| Total                                                       | 395                    | 52,214        | 902                                      | 575 | 753               | 21,370                          | 76,209                       | (142)            | 76,067                        |
| RoW                                                         |                        |               |                                          |     |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 72            | 5,274                                    | —   | 132               | 42                              | 5,520                        | (91)             | 5,429                         |
| Financial institutions - banks                              | 4,194                  | 3,262         | 653                                      | 82  | 23,705            | 878                             | 32,774                       | (23,453)         | 9,321                         |
| - other (2)                                                 | 4,226                  | 2,128         | 483                                      | 58  | 4,369             | 426                             | 11,690                       | (3,893)          | 7,797                         |
| Personal - mortgages                                        | —                      | 318           | —                                        | —   | —                 | —                               | 318                          | —                | 318                           |
| - unsecured                                                 | —                      | 1,053         | —                                        | —   | —                 | —                               | 1,053                        | —                | 1,053                         |
| Property                                                    | —                      | 491           | 219                                      | 3   | 42                | —                               | 755                          | —                | 755                           |
| Construction                                                | —                      | 6             | —                                        | 1   | 4                 | —                               | 11                           | —                | 11                            |
| Manufacturing                                               | —                      | 1,195         | 7                                        | 6   | 91                | 32                              | 1,331                        | (9)              | 1,322                         |
| Finance leases and instalment credit                        | —                      | 64            | —                                        | —   | 4                 | —                               | 68                           | —                | 68                            |
| Retail, wholesale and repairs                               | —                      | 1,583         | 6                                        | 15  | 122               | —                               | 1,726                        | (121)            | 1,605                         |
| Transport and storage                                       | —                      | 339           | 94                                       | 2   | 169               | —                               | 604                          | (156)            | 448                           |
| Health, education and leisure                               | —                      | 385           | —                                        | 4   | 12                | —                               | 401                          | —                | 401                           |
| Hotels and restaurants                                      | —                      | 15            | —                                        | —   | —                 | —                               | 15                           | —                | 15                            |
| Utilities                                                   | —                      | 434           | 14                                       | 4   | 71                | —                               | 523                          | —                | 523                           |
| Other                                                       | —                      | 1,992         | 45                                       | 68  | 342               | —                               | 2,447                        | (188)            | 2,259                         |
| Total third party                                           | 8,420                  | 13,337        | 6,795                                    | 243 | 29,063            | 1,378                           | 59,236                       | (27,911)         | 31,325                        |
| Amounts due from holding<br>company and fellow subsidiaries | —                      | 2,106         | —                                        | —   | 2,045             | —                               | 4,151                        | —                | 4,151                         |
| Total gross of provisions                                   | 8,420                  | 15,443        | 6,795                                    | 243 | 31,108            | 1,378                           | 63,387                       | (27,911)         | 35,476                        |
| Provisions                                                  | —                      | (186)         | (102)                                    | —   | —                 | —                               | (288)                        | n/a              | (288)                         |
| Total                                                       | 8,420                  | 15,257        | 6,693                                    | 243 | 31,108            | 1,378                           | 63,099                       | (27,911)         | 35,188                        |

For the notes to this table refer to page 108.

## Financial review *Risk and balance sheet management*

| 2011                                                        | Group                  |               |            |              |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|                                                             | £m                     | £m            | Debt<br>£m | Equity<br>£m | £m                | £m                              | £m                           | £m               | £m                            |
| <b>UK</b>                                                   |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | 2,130                  | 8,037         | 75,754     | —            | 5,198             | 548                             | 91,667                       | (1,098)          | 90,569                        |
| Financial institutions - banks                              | 24,543                 | 25,920        | —          | 977          | 261,382           | 40,364                          | 353,186                      | (274,012)        | 79,174                        |
| - other (2)                                                 | 38,909                 | 31,891        | 24,820     | 922          | 37,688            | 2,472                           | 136,702                      | (54,243)         | 82,459                        |
| Personal - mortgages                                        | —                      | 100,725       | —          | —            | —                 | —                               | 100,725                      | —                | 100,725                       |
| - unsecured                                                 | —                      | 19,345        | —          | —            | —                 | —                               | 19,345                       | (7)              | 19,338                        |
| Property                                                    | —                      | 55,727        | 167        | 137          | 4,181             | —                               | 60,212                       | (1,265)          | 58,947                        |
| Construction                                                | —                      | 7,173         | 20         | 26           | 874               | —                               | 8,093                        | (1,115)          | 6,978                         |
| Manufacturing                                               | 254                    | 10,400        | 336        | 1,908        | 2,077             | —                               | 14,975                       | (2,205)          | 12,770                        |
| Finance leases and instalment credit                        | —                      | 11,216        | —          | 2            | 73                | —                               | 11,291                       | (16)             | 11,275                        |
| Retail, wholesale and repairs                               | —                      | 12,512        | 307        | 2,404        | 902               | —                               | 16,125                       | (1,647)          | 14,478                        |
| Transport and storage                                       | 436                    | 11,454        | 51         | 67           | 2,138             | —                               | 14,146                       | (200)            | 13,946                        |
| Health, education and leisure                               | —                      | 9,491         | 45         | 8            | 744               | —                               | 10,288                       | (965)            | 9,323                         |
| Hotels and restaurants                                      | —                      | 6,168         | 14         | —            | 662               | —                               | 6,844                        | (178)            | 6,666                         |
| Utilities                                                   | —                      | 3,393         | 324        | 266          | 2,870             | —                               | 6,853                        | (450)            | 6,403                         |
| Other                                                       | 51                     | 18,552        | 1,062      | 3,947        | 3,943             | 453                             | 28,008                       | (946)            | 27,062                        |
| Total third party                                           | 66,323                 | 332,004       | 102,900    | 10,664       | 322,732           | 43,837                          | 878,460                      | (338,347)        | 540,113                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 26,823        | 785        | —            | 8,119             | —                               | 35,727                       | —                | 35,727                        |
| Total gross of provisions                                   | 66,323                 | 358,827       | 103,685    | 10,664       | 330,851           | 43,837                          | 914,187                      | (338,347)        | 575,840                       |
| Provisions                                                  | —                      | (8,210)       | (410)      | (141)        | —                 | —                               | (8,761)                      | n/a              | (8,761)                       |
| Total excluding disposal groups                             | 66,323                 | 350,617       | 103,275    | 10,523       | 330,851           | 43,837                          | 905,426                      | (338,347)        | 567,079                       |
| Disposal groups                                             | —                      | 18,679        | —          | —            | 430               | 100                             | 19,209                       | —                | 19,209                        |
| Total including disposal groups                             | 66,323                 | 369,296       | 103,275    | 10,523       | 331,281           | 43,937                          | 924,635                      | (338,347)        | 586,288                       |
| <b>US</b>                                                   |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 180           | 22,069     | —            | 9                 | 1                               | 22,259                       | —                | 22,259                        |
| Financial institutions - banks                              | 7,290                  | 642           | —          | 432          | 111,240           | 25,221                          | 144,825                      | (108,043)        | 36,782                        |
| - other (2)                                                 | 17,367                 | 9,150         | 31,082     | 560          | 54,225            | 2,724                           | 115,108                      | (60,573)         | 54,535                        |
| Personal - mortgages                                        | —                      | 23,237        | —          | —            | —                 | —                               | 23,237                       | —                | 23,237                        |
| - unsecured                                                 | —                      | 8,441         | —          | —            | —                 | —                               | 8,441                        | —                | 8,441                         |
| Property                                                    | —                      | 3,777         | 26         | 23           | 38                | —                               | 3,864                        | —                | 3,864                         |
| Construction                                                | —                      | 457           | 21         | 3            | 11                | —                               | 492                          | —                | 492                           |
| Manufacturing                                               | —                      | 6,553         | 101        | 12           | 452               | —                               | 7,118                        | —                | 7,118                         |
| Finance leases and instalment credit                        | —                      | 2,471         | —          | —            | —                 | —                               | 2,471                        | —                | 2,471                         |
| Retail, wholesale and repairs                               | —                      | 5,030         | 52         | —            | 63                | —                               | 5,145                        | —                | 5,145                         |
| Transport and storage                                       | —                      | 2,767         | 26         | 1            | 1,084             | —                               | 3,878                        | —                | 3,878                         |
| Health, education and leisure                               | —                      | 3,035         | 74         | 4            | 93                | —                               | 3,206                        | —                | 3,206                         |
| Hotels and restaurants                                      | —                      | 684           | 93         | 3            | 1                 | —                               | 781                          | —                | 781                           |
| Utilities                                                   | —                      | 944           | 243        | 16           | 295               | —                               | 1,498                        | —                | 1,498                         |
| Other                                                       | 29                     | 5,398         | 695        | 107          | 1,427             | —                               | 7,656                        | —                | 7,656                         |
| Total third party                                           | 24,686                 | 72,766        | 54,482     | 1,161        | 168,938           | 27,946                          | 349,979                      | (168,616)        | 181,363                       |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 315           | 17         | —            | 1,019             | —                               | 1,351                        | —                | 1,351                         |
| Total gross of provisions                                   | 24,686                 | 73,081        | 54,499     | 1,161        | 169,957           | 27,946                          | 351,330                      | (168,616)        | 182,714                       |
| Provisions                                                  | —                      | (1,229)       | (59)       | —            | —                 | —                               | (1,288)                      | n/a              | (1,288)                       |
| Total excluding disposal groups                             | 24,686                 | 71,852        | 54,440     | 1,161        | 169,957           | 27,946                          | 350,042                      | (168,616)        | 181,426                       |
| Disposal groups                                             | —                      | 25            | —          | 5            | 9                 | 15                              | 54                           | —                | 54                            |
| Total including disposal groups                             | 24,686                 | 71,877        | 54,440     | 1,166        | 169,966           | 27,961                          | 350,096                      | (168,616)        | 181,480                       |

For the notes to this table refer to page 108.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis: Financial assets continued

|                                                             | Group                  |               |            |              |                   |                                 |                              |                  |                               |
|-------------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                             | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|                                                             |                        |               | Debt<br>£m | Equity<br>£m |                   |                                 |                              |                  |                               |
| 2011                                                        |                        |               |            |              |                   |                                 |                              |                  |                               |
| <b>Europe</b>                                               |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | —                      | 558           | 333        | —            | 58                | —                               | 949                          | —                | 949                           |
| Financial institutions - banks                              | 247                    | 2,706         | —          | 28           | —                 | 815                             | 3,796                        | —                | 3,796                         |
| - other (2)                                                 | —                      | 1,177         | 148        | 6            | 124               | 25                              | 1,480                        | (1)              | 1,479                         |
| Personal - mortgages                                        | —                      | 18,334        | —          | —            | —                 | —                               | 18,334                       | —                | 18,334                        |
| - unsecured                                                 | —                      | 2,188         | —          | —            | —                 | 7                               | 2,195                        | —                | 2,195                         |
| Property                                                    | —                      | 15,771        | —          | —            | 167               | —                               | 15,938                       | (9)              | 15,929                        |
| Construction                                                | —                      | 1,042         | —          | —            | 18                | —                               | 1,060                        | (24)             | 1,036                         |
| Manufacturing                                               | —                      | 4,700         | 5          | 1            | 10                | —                               | 4,716                        | (9)              | 4,707                         |
| Finance leases and instalment credit                        | —                      | 690           | —          | —            | —                 | —                               | 690                          | —                | 690                           |
| Retail, wholesale and repairs                               | —                      | 2,345         | 4          | 2            | 5                 | —                               | 2,356                        | (24)             | 2,332                         |
| Transport and storage                                       | —                      | 5,633         | 2          | —            | 13                | —                               | 5,648                        | (6)              | 5,642                         |
| Health, education and leisure                               | —                      | 1,435         | —          | 1            | 2                 | —                               | 1,438                        | (8)              | 1,430                         |
| Hotels and restaurants                                      | —                      | 1,363         | —          | —            | 6                 | —                               | 1,369                        | (6)              | 1,363                         |
| Utilities                                                   | —                      | 1,605         | 36         | 3            | 33                | —                               | 1,677                        | —                | 1,677                         |
| Other                                                       | 7                      | 2,245         | 50         | 8            | 5                 | —                               | 2,315                        | (56)             | 2,259                         |
| Total third party                                           | 254                    | 61,792        | 578        | 49           | 441               | 847                             | 63,961                       | (143)            | 63,818                        |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 221           | —          | —            | 5                 | —                               | 226                          | —                | 226                           |
| Total gross of provisions                                   | 254                    | 62,013        | 578        | 49           | 446               | 847                             | 64,187                       | (143)            | 64,044                        |
| Provisions                                                  | —                      | (8,825)       | —          | —            | —                 | —                               | (8,825)                      | n/a              | (8,825)                       |
| Total excluding disposal groups                             | 254                    | 53,188        | 578        | 49           | 446               | 847                             | 55,362                       | (143)            | 55,219                        |
| Disposal groups                                             | —                      | —             | —          | —            | —                 | 17                              | 17                           | —                | 17                            |
| Total including disposal groups                             | 254                    | 53,188        | 578        | 49           | 446               | 864                             | 55,379                       | (143)            | 55,236                        |
| <b>RoW</b>                                                  |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                                | 117                    | 79            | 8,185      | —            | 190               | —                               | 8,571                        | —                | 8,571                         |
| Financial institutions - banks                              | 5,680                  | 2,965         | —          | 11           | 27,700            | 2,087                           | 38,443                       | (24,954)         | 13,489                        |
| - other (2)                                                 | 1,957                  | 2,852         | 2,221      | 2            | 597               | 395                             | 8,024                        | (2,785)          | 5,239                         |
| Personal - mortgages                                        | —                      | 380           | —          | —            | —                 | —                               | 380                          | —                | 380                           |
| - unsecured                                                 | —                      | 1,507         | —          | —            | —                 | —                               | 1,507                        | —                | 1,507                         |
| Property                                                    | —                      | 728           | 269        | 14           | 60                | 1                               | 1,072                        | —                | 1,072                         |
| Construction                                                | —                      | 9             | 9          | —            | 2                 | —                               | 20                           | —                | 20                            |
| Manufacturing                                               | —                      | 412           | 4          | —            | 778               | 306                             | 1,500                        | —                | 1,500                         |
| Finance leases and instalment credit                        | —                      | 37            | 127        | —            | —                 | —                               | 164                          | —                | 164                           |
| Retail, wholesale and repairs                               | —                      | 288           | 3          | —            | 75                | —                               | 366                          | —                | 366                           |
| Transport and storage                                       | —                      | 397           | 128        | —            | 147               | —                               | 672                          | —                | 672                           |
| Health, education and leisure                               | —                      | 581           | —          | —            | 32                | —                               | 613                          | —                | 613                           |
| Hotels and restaurants                                      | —                      | 14            | —          | —            | —                 | —                               | 14                           | —                | 14                            |
| Utilities                                                   | —                      | 644           | 5          | —            | 68                | —                               | 717                          | —                | 717                           |
| Other                                                       | —                      | 597           | 14         | 2            | 667               | 2                               | 1,282                        | —                | 1,282                         |
| Total third party                                           | 7,754                  | 11,490        | 10,965     | 29           | 30,316            | 2,791                           | 63,345                       | (27,739)         | 35,606                        |
| Amounts due from holding company<br>and fellow subsidiaries | —                      | 665           | —          | —            | 1,237             | —                               | 1,902                        | —                | 1,902                         |
| Total gross of provisions                                   | 7,754                  | 12,155        | 10,965     | 29           | 31,553            | 2,791                           | 65,247                       | (27,739)         | 37,508                        |
| Provisions                                                  | —                      | (290)         | (117)      | —            | —                 | —                               | (407)                        | n/a              | (407)                         |
| Total excluding disposal groups                             | 7,754                  | 11,865        | 10,848     | 29           | 31,553            | 2,791                           | 64,840                       | (27,739)         | 37,101                        |
| Disposal groups                                             | —                      | 44            | —          | —            | —                 | —                               | 44                           | —                | 44                            |
| Total including disposal groups                             | 7,754                  | 11,909        | 10,848     | 29           | 31,553            | 2,791                           | 64,884                       | (27,739)         | 37,145                        |

#### Notes:

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

## Financial review *Risk and balance sheet management*

The following tables provide an analysis of credit concentration of the Bank's financial assets by sector and geography. Geographical regions are based on the location of the lending or issuing office.

| 2013                                                 | Bank                   |               |            |              |                   |                                 |                              |                  | Exposure<br>post offset<br>£m |
|------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                      | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m |                               |
|                                                      |                        |               | Debt<br>£m | Equity<br>£m |                   |                                 |                              |                  |                               |
| <b>UK</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | —                      | 5,253         | 13,206     | —            | 3,816             | 122                             | 22,397                       | (3,109)          | 19,288                        |
| Financial institutions - banks                       | 18,448                 | 11,619        | 2,750      | 423          | 131,310           | 54,308                          | 218,858                      | (141,310)        | 77,548                        |
| - other (2)                                          | 19,290                 | 23,085        | 11,575     | 1,545        | 55,748            | 2,236                           | 113,479                      | (68,931)         | 44,548                        |
| Personal - mortgages                                 | —                      | 35,668        | —          | —            | —                 | —                               | 35,668                       | —                | 35,668                        |
| - unsecured                                          | —                      | 4,321         | —          | —            | —                 | —                               | 4,321                        | (3)              | 4,318                         |
| Property                                             | —                      | 23,328        | 235        | 175          | 2,381             | —                               | 26,119                       | (414)            | 25,705                        |
| Construction                                         | —                      | 1,906         | 22         | 98           | 406               | —                               | 2,432                        | (268)            | 2,164                         |
| Manufacturing                                        | 466                    | 4,302         | 345        | 2,136        | 942               | 2                               | 8,193                        | (1,625)          | 6,568                         |
| Finance leases and instalment credit                 | —                      | 104           | 3          | 4            | 11                | —                               | 122                          | (2)              | 120                           |
| Retail, wholesale and repairs                        | —                      | 3,483         | 154        | 423          | 623               | —                               | 4,683                        | (570)            | 4,113                         |
| Transport and storage                                | —                      | 7,383         | 141        | 62           | 1,629             | —                               | 9,215                        | (481)            | 8,734                         |
| Health, education and leisure                        | —                      | 5,360         | 39         | 78           | 437               | —                               | 5,914                        | (248)            | 5,666                         |
| Hotels and restaurants                               | —                      | 2,592         | 1          | 50           | 175               | —                               | 2,818                        | (81)             | 2,737                         |
| Utilities                                            | —                      | 1,572         | 123        | 279          | 2,826             | —                               | 4,800                        | (737)            | 4,063                         |
| Other                                                | 18                     | 7,389         | —          | 1,735        | 1,396             | 17                              | 10,555                       | (1,299)          | 9,256                         |
| Total third party                                    | 38,222                 | 137,365       | 28,594     | 7,008        | 201,700           | 56,685                          | 469,574                      | (219,078)        | 250,496                       |
| Amounts due from holding company<br>and subsidiaries | —                      | 73,249        | 26,449     | —            | 7,761             | 5                               | 107,464                      | (3,870)          | 103,594                       |
| Total gross of provisions                            | 38,222                 | 210,614       | 55,043     | 7,008        | 209,461           | 56,690                          | 577,038                      | (222,948)        | 354,090                       |
| Provisions                                           | —                      | (4,837)       | (107)      | (23)         | —                 | —                               | (4,967)                      | n/a              | (4,967)                       |
| Total                                                | 38,222                 | 205,777       | 54,936     | 6,985        | 209,461           | 56,690                          | 572,071                      | (222,948)        | 349,123                       |
| <b>US</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | —                      | 159           | 7,952      | —            | 21                | —                               | 8,132                        | (12)             | 8,120                         |
| Financial institutions - banks                       | 7                      | 229           | —          | —            | 53,154            | 15,576                          | 68,966                       | (53,339)         | 15,627                        |
| - other (2)                                          | 4,396                  | 2,375         | 1,121      | 23           | 9,371             | 734                             | 18,020                       | (9,289)          | 8,731                         |
| Property                                             | —                      | 388           | —          | —            | 21                | —                               | 409                          | (7)              | 402                           |
| Construction                                         | —                      | 46            | —          | 5            | 2                 | —                               | 53                           | —                | 53                            |
| Manufacturing                                        | —                      | 1,558         | —          | 7            | 128               | —                               | 1,693                        | (56)             | 1,637                         |
| Finance leases and instalment credit                 | —                      | 37            | —          | —            | 1                 | —                               | 38                           | —                | 38                            |
| Retail, wholesale and repairs                        | —                      | 420           | —          | 1            | 32                | —                               | 453                          | (6)              | 447                           |
| Transport and storage                                | —                      | 689           | —          | —            | 370               | —                               | 1,059                        | (141)            | 918                           |
| Health, education and leisure                        | —                      | 190           | —          | 1            | 37                | —                               | 228                          | —                | 228                           |
| Hotels and restaurants                               | —                      | 15            | —          | —            | 1                 | —                               | 16                           | —                | 16                            |
| Utilities                                            | —                      | 361           | —          | —            | 149               | —                               | 510                          | (27)             | 483                           |
| Other                                                | 8                      | 1,366         | 2          | 7            | 145               | —                               | 1,528                        | (20)             | 1,508                         |
| Total third party                                    | 4,411                  | 7,833         | 9,075      | 44           | 63,432            | 16,310                          | 101,105                      | (62,897)         | 38,208                        |
| Amounts due from holding company<br>and subsidiaries | —                      | 3,433         | —          | —            | 933               | —                               | 4,366                        | —                | 4,366                         |
| Total gross of provisions                            | 4,411                  | 11,266        | 9,075      | 44           | 64,365            | 16,310                          | 105,471                      | (62,897)         | 42,574                        |
| Provisions                                           | —                      | (120)         | —          | —            | —                 | —                               | (120)                        | n/a              | (120)                         |
| Total                                                | 4,411                  | 11,146        | 9,075      | 44           | 64,365            | 16,310                          | 105,351                      | (62,897)         | 42,454                        |

For the notes to this table refer to page 114.

## Financial review Risk and balance sheet management

### Balance sheet analysis: Financial assets continued

|                                                   | Bank    |         |            |        |             |                  |             |            |             |
|---------------------------------------------------|---------|---------|------------|--------|-------------|------------------|-------------|------------|-------------|
|                                                   | Reverse |         | Securities |        |             | Other            | Balance     |            | Exposure    |
|                                                   | repos   | Lending | Debt       | Equity | Derivatives | financial assets | sheet value | Offset (1) | post offset |
| 2013                                              | £m      | £m      | £m         | £m     | £m          | £m               | £m          | £m         | £m          |
| Europe                                            |         |         |            |        |             |                  |             |            |             |
| Central and local government                      | —       | 628     | 25,592     | —      | 30          | —                | 26,250      | —          | 26,250      |
| Financial institutions - banks                    | 427     | 602     | 308        | —      | —           | 4,313            | 5,650       | —          | 5,650       |
| - other (2)                                       | —       | 974     | —          | 17     | —           | 1                | 992         | —          | 992         |
| Personal - mortgages                              | —       | 4       | —          | —      | —           | —                | 4           | —          | 4           |
| - unsecured                                       | —       | 3       | —          | —      | —           | —                | 3           | —          | 3           |
| Property                                          | —       | 1,779   | —          | 29     | —           | —                | 1,808       | —          | 1,808       |
| Construction                                      | —       | 523     | —          | —      | —           | —                | 523         | —          | 523         |
| Manufacturing                                     | —       | 2,450   | —          | 3      | 7           | 22               | 2,482       | (1)        | 2,481       |
| Retail, wholesale and repairs                     | —       | 1,345   | —          | —      | 1           | —                | 1,346       | —          | 1,346       |
| Transport and storage                             | —       | 4,447   | —          | —      | —           | —                | 4,447       | —          | 4,447       |
| Health, education and leisure                     | —       | 209     | —          | —      | —           | —                | 209         | —          | 209         |
| Hotels and restaurants                            | —       | 205     | —          | —      | —           | —                | 205         | —          | 205         |
| Utilities                                         | —       | 1,041   | —          | —      | 2           | —                | 1,043       | —          | 1,043       |
| Other                                             | —       | 1,352   | —          | 1      | 2           | —                | 1,355       | —          | 1,355       |
| Total third party                                 | 427     | 15,562  | 25,900     | 50     | 42          | 4,336            | 46,317      | (1)        | 46,316      |
| Amounts due from holding company and subsidiaries | —       | 1,054   | —          | —      | 79          | 50               | 1,183       | —          | 1,183       |
| Total gross of provisions                         | 427     | 16,616  | 25,900     | 50     | 121         | 4,386            | 47,500      | (1)        | 47,499      |
| Provisions                                        | —       | (1,104) | —          | —      | —           | —                | (1,104)     | n/a        | (1,104)     |
| Total                                             | 427     | 15,512  | 25,900     | 50     | 121         | 4,386            | 46,396      | (1)        | 46,395      |
| RoW                                               |         |         |            |        |             |                  |             |            |             |
| Central and local government                      | —       | 70      | 1,129      | —      | 119         | 6                | 1,324       | (70)       | 1,254       |
| Financial institutions - banks                    | 229     | 5,159   | 597        | 72     | 14,349      | 1,595            | 22,001      | (11,846)   | 10,155      |
| - other (2)                                       | 473     | 1,320   | 3          | 50     | 3,662       | 39               | 5,547       | (3,442)    | 2,105       |
| Personal - mortgages                              | —       | 253     | —          | —      | —           | —                | 253         | —          | 253         |
| - unsecured                                       | —       | 2       | —          | —      | —           | —                | 2           | —          | 2           |
| Property                                          | —       | 476     | 139        | 3      | 20          | —                | 638         | (1)        | 637         |
| Construction                                      | —       | 329     | —          | 1      | 32          | —                | 362         | (4)        | 358         |
| Manufacturing                                     | —       | 2,152   | 2          | 6      | 76          | —                | 2,236       | (46)       | 2,190       |
| Finance leases and instalment credit              | —       | 45      | 3          | —      | 1           | —                | 49          | (1)        | 48          |
| Retail, wholesale and repairs                     | —       | 783     | 3          | 14     | 98          | —                | 898         | (27)       | 871         |
| Transport and storage                             | —       | 641     | 82         | 2      | 56          | —                | 781         | (17)       | 764         |
| Health, education and leisure                     | —       | 186     | —          | 4      | 3           | —                | 193         | —          | 193         |
| Hotels and restaurants                            | —       | 34      | —          | —      | —           | —                | 34          | —          | 34          |
| Utilities                                         | —       | 461     | 15         | 3      | 136         | 23               | 638         | (10)       | 628         |
| Other                                             | —       | 1,890   | 82         | 67     | 187         | —                | 2,226       | (79)       | 2,147       |
| Total third party                                 | 702     | 13,801  | 2,055      | 222    | 18,739      | 1,663            | 37,182      | (15,543)   | 21,639      |
| Amounts due from holding company and subsidiaries | —       | 13,319  | 394        | —      | 194         | 235              | 14,142      | —          | 14,142      |
| Total gross of provisions                         | 702     | 27,120  | 2,449      | 222    | 18,933      | 1,898            | 51,324      | (15,543)   | 35,781      |
| Provisions                                        | —       | (175)   | (33)       | —      | —           | —                | (208)       | n/a        | (208)       |
| Total                                             | 702     | 26,945  | 2,416      | 222    | 18,933      | 1,898            | 51,116      | (15,543)   | 35,573      |

For the notes to this table refer to page 114.

## Financial review *Risk and balance sheet management*

| 2012                                                 | Bank                   |               |            |              |                   |                                 |                              |                  |                               |
|------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                      | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|                                                      | £m                     | £m            | Debt<br>£m | Equity<br>£m | £m                | £m                              | £m                           | £m               | £m                            |
| <b>UK</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | 441                    | 6,454         | 60,725     | —            | 5,530             | 47                              | 73,197                       | (4,375)          | 68,822                        |
| Financial institutions - banks                       | 24,850                 | 14,810        | 4,057      | 1,075        | 193,860           | 39,490                          | 278,142                      | (201,458)        | 76,684                        |
| - other (2)                                          | 42,200                 | 26,267        | 14,967     | 2,381        | 60,648            | 2,024                           | 148,487                      | (78,257)         | 70,230                        |
| Personal - mortgages                                 | —                      | 38,988        | —          | —            | —                 | —                               | 38,988                       | —                | 38,988                        |
| - unsecured                                          | —                      | 4,651         | —          | —            | —                 | —                               | 4,651                        | (5)              | 4,646                         |
| Property                                             | —                      | 29,227        | 96         | 211          | 3,299             | —                               | 32,833                       | (514)            | 32,319                        |
| Construction                                         | —                      | 3,283         | 14         | 248          | 769               | —                               | 4,314                        | (608)            | 3,706                         |
| Manufacturing                                        | 325                    | 4,736         | 12         | 1,496        | 1,214             | 94                              | 7,877                        | (2,103)          | 5,774                         |
| Finance leases and instalment credit                 | —                      | 170           | 49         | —            | —                 | —                               | 219                          | —                | 219                           |
| Retail, wholesale and repairs                        | —                      | 4,046         | 194        | 1,551        | 617               | 40                              | 6,448                        | (385)            | 6,063                         |
| Transport and storage                                | —                      | 8,748         | 120        | 361          | 1,992             | 2                               | 11,223                       | (1,880)          | 9,343                         |
| Health, education and leisure                        | —                      | 5,316         | 56         | 548          | 524               | 28                              | 6,472                        | (194)            | 6,278                         |
| Hotels and restaurants                               | —                      | 2,964         | 73         | 51           | 421               | 11                              | 3,520                        | (223)            | 3,297                         |
| Utilities                                            | —                      | 2,851         | 282        | 440          | 2,508             | 19                              | 6,100                        | (1,980)          | 4,120                         |
| Other                                                | 19                     | 8,099         | 413        | 3,620        | 2,487             | 86                              | 14,724                       | (1,325)          | 13,399                        |
| Total third party                                    | 67,835                 | 160,610       | 81,058     | 11,982       | 273,869           | 41,841                          | 637,195                      | (293,307)        | 343,888                       |
| Amounts due from holding company<br>and subsidiaries | —                      | 114,447       | 32,338     | —            | 11,016            | —                               | 157,801                      | —                | 157,801                       |
| Total gross of provisions                            | 67,835                 | 275,057       | 113,396    | 11,982       | 284,885           | 41,841                          | 794,996                      | (293,307)        | 501,689                       |
| Provisions                                           | —                      | (4,863)       | (260)      | (23)         | —                 | —                               | (5,146)                      | n/a              | (5,146)                       |
| Total                                                | 67,835                 | 270,194       | 113,136    | 11,959       | 284,885           | 41,841                          | 789,850                      | (293,307)        | 496,543                       |
| <b>US</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | —                      | 39            | 3,361      | —            | 23                | —                               | 3,423                        | (17)             | 3,406                         |
| Financial institutions - banks                       | 13                     | 88            | —          | —            | 116,711           | 9,748                           | 126,560                      | (115,459)        | 11,101                        |
| - other (2)                                          | —                      | 1,670         | 932        | 10           | 13,305            | 462                             | 16,379                       | (11,717)         | 4,662                         |
| Property                                             | —                      | 134           | —          | 21           | 34                | —                               | 189                          | —                | 189                           |
| Construction                                         | —                      | 131           | —          | 1            | 9                 | —                               | 141                          | —                | 141                           |
| Manufacturing                                        | —                      | 1,380         | —          | 12           | 217               | —                               | 1,609                        | (215)            | 1,394                         |
| Finance leases and instalment credit                 | —                      | 44            | —          | —            | —                 | —                               | 44                           | —                | 44                            |
| Retail, wholesale and repairs                        | —                      | 381           | —          | —            | 66                | —                               | 447                          | (52)             | 395                           |
| Transport and storage                                | —                      | 764           | 6          | —            | 855               | —                               | 1,625                        | (800)            | 825                           |
| Health, education and leisure                        | —                      | 226           | —          | —            | 73                | —                               | 299                          | (70)             | 229                           |
| Hotels and restaurants                               | —                      | 61            | —          | —            | —                 | —                               | 61                           | —                | 61                            |
| Utilities                                            | —                      | 417           | 1          | —            | 258               | —                               | 676                          | (251)            | 425                           |
| Other                                                | —                      | 1,910         | 70         | 3            | 333               | —                               | 2,316                        | (277)            | 2,039                         |
| Total third party                                    | 13                     | 7,245         | 4,370      | 47           | 131,884           | 10,210                          | 153,769                      | (128,858)        | 24,911                        |
| Amounts due from holding company<br>and subsidiaries | —                      | 2,188         | —          | —            | 1,893             | —                               | 4,081                        | —                | 4,081                         |
| Total gross of provisions                            | 13                     | 9,433         | 4,370      | 47           | 133,777           | 10,210                          | 157,850                      | (128,858)        | 28,992                        |
| Provisions                                           | —                      | (167)         | (45)       | —            | —                 | —                               | (212)                        | n/a              | (212)                         |
| Total                                                | 13                     | 9,266         | 4,325      | 47           | 133,777           | 10,210                          | 157,638                      | (128,858)        | 28,780                        |

For the notes to this table refer to page 114.



## Financial review *Risk and balance sheet management*

### Balance sheet analysis: Financial assets continued

|                                                   |         |         | Bank       |        |             |                  |             |            |             |  |
|---------------------------------------------------|---------|---------|------------|--------|-------------|------------------|-------------|------------|-------------|--|
|                                                   | Reverse | Lending | Securities |        | Derivatives | Other            | Balance     |            | Exposure    |  |
|                                                   | repos   |         | Debt       | Equity |             | financial assets | sheet value | Offset (1) | post offset |  |
| 2012                                              | £m      | £m      | £m         | £m     | £m          | £m               | £m          | £m         | £m          |  |
| Europe                                            |         |         |            |        |             |                  |             |            |             |  |
| Central and local government                      | —       | 752     | 313        | —      | 38          | —                | 1,103       | (15)       | 1,088       |  |
| Financial institutions - banks                    | —       | 851     | —          | —      | 2           | 20,258           | 21,111      | (2)        | 21,109      |  |
| - other (2)                                       | 10      | 1,141   | —          | 117    | 7           | 23               | 1,298       | —          | 1,298       |  |
| Personal - mortgages                              | —       | 3       | —          | —      | —           | —                | 3           | —          | 3           |  |
| - unsecured                                       | —       | 53      | —          | —      | —           | —                | 53          | —          | 53          |  |
| Property                                          | —       | 2,089   | —          | —      | —           | —                | 2,089       | —          | 2,089       |  |
| Construction                                      | —       | 589     | —          | 6      | —           | —                | 595         | —          | 595         |  |
| Manufacturing                                     | —       | 3,704   | —          | 16     | 7           | 1                | 3,728       | —          | 3,728       |  |
| Retail, wholesale and repairs                     | —       | 1,479   | —          | 109    | —           | —                | 1,588       | —          | 1,588       |  |
| Transport and storage                             | —       | 4,210   | —          | 10     | 1           | —                | 4,221       | —          | 4,221       |  |
| Health, education and leisure                     | —       | 648     | —          | —      | —           | —                | 648         | —          | 648         |  |
| Hotels and restaurants                            | —       | 156     | —          | —      | —           | —                | 156         | —          | 156         |  |
| Utilities                                         | —       | 794     | —          | 112    | 1           | 20               | 927         | —          | 927         |  |
| Other                                             | —       | 2,531   | 1          | 165    | 25          | —                | 2,722       | —          | 2,722       |  |
| Total third party                                 | 10      | 19,000  | 314        | 535    | 81          | 20,302           | 40,242      | (17)       | 40,225      |  |
| Amounts due from holding company and subsidiaries | —       | 1,220   | —          | —      | 1           | —                | 1,221       | —          | 1,221       |  |
| Total gross of provisions                         | 10      | 20,220  | 314        | 535    | 82          | 20,302           | 41,463      | (17)       | 41,446      |  |
| Provisions                                        | —       | (358)   | —          | —      | —           | —                | (358)       | n/a        | (358)       |  |
| Total                                             | 10      | 19,862  | 314        | 535    | 82          | 20,302           | 41,105      | (17)       | 41,088      |  |
| RoW                                               |         |         |            |        |             |                  |             |            |             |  |
| Central and local government                      | —       | 72      | 2,341      | —      | 132         | 42               | 2,587       | (91)       | 2,496       |  |
| Financial institutions - banks                    | 731     | 2,665   | 653        | 76     | 23,705      | 878              | 28,708      | (23,453)   | 5,255       |  |
| - other (2)                                       | —       | 1,374   | 444        | 47     | 4,357       | 191              | 6,413       | (3,893)    | 2,520       |  |
| Personal - mortgages                              | —       | 308     | —          | —      | —           | —                | 308         | —          | 308         |  |
| - unsecured                                       | —       | 2       | —          | —      | —           | —                | 2           | —          | 2           |  |
| Property                                          | —       | 455     | 219        | 3      | 42          | —                | 719         | —          | 719         |  |
| Construction                                      | —       | 6       | —          | 1      | 4           | —                | 11          | —          | 11          |  |
| Manufacturing                                     | —       | 1,186   | 7          | 6      | 91          | —                | 1,290       | (9)        | 1,281       |  |
| Finance leases and instalment credit              | —       | 64      | —          | —      | 4           | —                | 68          | —          | 68          |  |
| Retail, wholesale and repairs                     | —       | 1,570   | 6          | 15     | 122         | —                | 1,713       | (121)      | 1,592       |  |
| Transport and storage                             | —       | 339     | 94         | 2      | 169         | —                | 604         | (156)      | 448         |  |
| Health, education and leisure                     | —       | 385     | —          | 4      | 12          | —                | 401         | —          | 401         |  |
| Hotels and restaurants                            | —       | 15      | —          | —      | —           | —                | 15          | —          | 15          |  |
| Utilities                                         | —       | 434     | 12         | 4      | 71          | —                | 521         | —          | 521         |  |
| Other                                             | —       | 1,288   | 39         | 67     | 342         | —                | 1,736       | (188)      | 1,548       |  |
| Total third party                                 | 731     | 10,163  | 3,815      | 225    | 29,051      | 1,111            | 45,096      | (27,911)   | 17,185      |  |
| Amounts due from holding company and subsidiaries | —       | 3,284   | 959        | —      | 2,043       | —                | 6,286       | —          | 6,286       |  |
| Total gross of provisions                         | 731     | 13,447  | 4,774      | 225    | 31,094      | 1,111            | 51,382      | (27,911)   | 23,471      |  |
| Provisions                                        | —       | (238)   | (102)      | —      | —           | —                | (340)       | n/a        | (340)       |  |
| Total                                             | 731     | 13,209  | 4,672      | 225    | 31,094      | 1,111            | 51,042      | (27,911)   | 23,131      |  |

For the notes to this table refer to page 114.

## Financial review *Risk and balance sheet management*

| 2011                                                 | Bank                   |               |            |              |                   |                                 |                              |                  |                               |
|------------------------------------------------------|------------------------|---------------|------------|--------------|-------------------|---------------------------------|------------------------------|------------------|-------------------------------|
|                                                      | Reverse<br>repos<br>£m | Lending<br>£m | Securities |              | Derivatives<br>£m | Other<br>financial assets<br>£m | Balance<br>sheet value<br>£m | Offset (1)<br>£m | Exposure<br>post offset<br>£m |
|                                                      | £m                     | £m            | Debt<br>£m | Equity<br>£m | £m                | £m                              | £m                           | £m               | £m                            |
| <b>UK</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | 2,130                  | 5,784         | 76,347     | —            | 5,190             | 548                             | 89,999                       | (478)            | 89,521                        |
| Financial institutions - banks                       | 24,536                 | 22,694        | —          | 1,066        | 238,675           | 38,872                          | 325,843                      | (233,038)        | 92,805                        |
| - other (2)                                          | 38,917                 | 24,471        | 21,887     | 929          | 59,715            | 2,459                           | 148,378                      | (94,787)         | 53,591                        |
| Personal - mortgages                                 | —                      | 35,707        | —          | —            | —                 | —                               | 35,707                       | —                | 35,707                        |
| - unsecured                                          | —                      | 3,334         | —          | —            | —                 | —                               | 3,334                        | (7)              | 3,327                         |
| Property & construction                              | —                      | 31,920        | 857        | 93           | 4,382             | —                               | 37,252                       | (533)            | 36,719                        |
| Manufacturing                                        | 254                    | 5,285         | 336        | 1,908        | 1,993             | —                               | 9,776                        | (734)            | 9,042                         |
| Finance leases and instalment credit                 | —                      | 84            | —          | —            | 73                | —                               | 157                          | (16)             | 141                           |
| Retail, wholesale and repairs                        | —                      | 4,378         | 307        | 2,403        | 798               | —                               | 7,886                        | (268)            | 7,618                         |
| Transport and storage                                | 436                    | 9,613         | 51         | 67           | 2,112             | —                               | 12,279                       | (38)             | 12,241                        |
| Health, education and leisure                        | —                      | 3,094         | 45         | —            | 454               | —                               | 3,593                        | (166)            | 3,427                         |
| Hotels and restaurants                               | —                      | 3,072         | 14         | —            | 584               | —                               | 3,670                        | (69)             | 3,601                         |
| Utilities                                            | —                      | 2,734         | 324        | 265          | 2,809             | —                               | 6,132                        | (13)             | 6,119                         |
| Other                                                | 51                     | 10,640        | 1,056      | 3,715        | 3,834             | 375                             | 19,671                       | (216)            | 19,455                        |
| Total third party                                    | 66,324                 | 162,810       | 101,224    | 10,446       | 320,619           | 42,254                          | 703,677                      | (330,363)        | 373,314                       |
| Amounts due from holding<br>company and subsidiaries | —                      | 195,223       | 69,531     | —            | 14,888            | —                               | 279,642                      | —                | 279,642                       |
| Total gross of provisions                            | 66,324                 | 358,033       | 170,755    | 10,446       | 335,507           | 42,254                          | 983,319                      | (330,363)        | 652,956                       |
| Provisions                                           | —                      | (2,771)       | (401)      | (52)         | —                 | —                               | (3,224)                      | n/a              | (3,224)                       |
| Total excluding disposal groups                      | 66,324                 | 355,262       | 170,354    | 10,394       | 335,507           | 42,254                          | 980,095                      | (330,363)        | 649,732                       |
| Disposal groups                                      | —                      | 18,066        | —          | —            | 414               | 94                              | 18,574                       | —                | 18,574                        |
| Total including disposal groups                      | 66,324                 | 373,328       | 170,354    | 10,394       | 335,921           | 42,348                          | 998,669                      | (330,363)        | 668,306                       |
| <b>US</b>                                            |                        |               |            |              |                   |                                 |                              |                  |                               |
| Central and local government                         | —                      | 44            | 2,162      | —            | 9                 | —                               | 2,215                        | —                | 2,215                         |
| Financial institutions - banks                       | 14                     | 23            | —          | 16           | 132,223           | 23,021                          | 155,297                      | (129,001)        | 26,296                        |
| - other (2)                                          | —                      | 1,817         | 1,435      | 6            | 33,056            | 336                             | 36,650                       | (33,626)         | 3,024                         |
| Property & construction                              | —                      | 361           | —          | 22           | 49                | —                               | 432                          | —                | 432                           |
| Manufacturing                                        | —                      | 1,821         | —          | 10           | 452               | —                               | 2,283                        | —                | 2,283                         |
| Finance leases and instalment credit                 | —                      | 51            | —          | —            | —                 | —                               | 51                           | —                | 51                            |
| Retail, wholesale and repairs                        | —                      | 278           | 1          | —            | 63                | —                               | 342                          | —                | 342                           |
| Transport and storage                                | —                      | 1,381         | 11         | 1            | 1,084             | —                               | 2,477                        | —                | 2,477                         |
| Health, education and leisure                        | —                      | 322           | —          | —            | 90                | —                               | 412                          | —                | 412                           |
| Hotels and restaurants                               | —                      | 177           | —          | 2            | 1                 | —                               | 180                          | —                | 180                           |
| Utilities                                            | —                      | 370           | 4          | —            | 295               | —                               | 669                          | —                | 669                           |
| Other                                                | 23                     | 1,883         | 67         | 3            | 586               | —                               | 2,562                        | —                | 2,562                         |
| Total third party                                    | 37                     | 8,528         | 3,680      | 60           | 167,908           | 23,357                          | 203,570                      | (162,627)        | 40,943                        |
| Amounts due from holding<br>company and subsidiaries | —                      | 2,654         | —          | —            | 2,141             | —                               | 4,795                        | —                | 4,795                         |
| Total gross of provisions                            | 37                     | 11,182        | 3,680      | 60           | 170,049           | 23,357                          | 208,365                      | (162,627)        | 45,738                        |
| Provisions                                           | —                      | (92)          | (57)       | —            | —                 | —                               | (149)                        | n/a              | (149)                         |
| Total excluding disposal groups                      | 37                     | 11,090        | 3,623      | 60           | 170,049           | 23,357                          | 208,216                      | (162,627)        | 45,589                        |
| Disposal groups                                      | —                      | 2             | —          | —            | —                 | —                               | 2                            | —                | 2                             |
| Total including disposal groups                      | 37                     | 11,092        | 3,623      | 60           | 170,049           | 23,357                          | 208,218                      | (162,627)        | 45,591                        |

For the notes to this table refer to page 114.

## Financial review Risk and balance sheet management

### Balance sheet analysis: Financial assets continued

|                                                   | Reverse<br>repos | Lending | Securities |        | Bank        | Other            | Balance     | Non-IFRS   | Exposure    |
|---------------------------------------------------|------------------|---------|------------|--------|-------------|------------------|-------------|------------|-------------|
|                                                   | £m               | £m      | Debt       | Equity | Derivatives | financial assets | sheet value | offset (1) | post offset |
| 2011                                              | £m               | £m      | £m         | £m     | £m          | £m               | £m          | £m         | £m          |
| <b>Europe</b>                                     |                  |         |            |        |             |                  |             |            |             |
| Central and local government                      | —                | 461     | —          | —      | 21          | —                | 482         | —          | 482         |
| Financial institutions - banks                    | —                | 144     | —          | 10     | —           | 281              | 435         | —          | 435         |
| - other (2)                                       | —                | 679     | —          | 8      | —           | —                | 687         | —          | 687         |
| Personal - mortgages                              | —                | 1       | —          | —      | —           | —                | 1           | —          | 1           |
| - unsecured                                       | —                | 3       | —          | —      | —           | —                | 3           | —          | 3           |
| Property & construction                           | —                | 2,692   | —          | —      | —           | —                | 2,692       | —          | 2,692       |
| Manufacturing                                     | —                | 3,703   | —          | —      | —           | —                | 3,703       | —          | 3,703       |
| Retail, wholesale and repairs                     | —                | 418     | —          | —      | —           | —                | 418         | —          | 418         |
| Transport and storage                             | —                | 4,774   | —          | —      | —           | —                | 4,774       | —          | 4,774       |
| Health, education and leisure                     | —                | 505     | —          | —      | —           | —                | 505         | —          | 505         |
| Hotels and restaurants                            | —                | 126     | —          | —      | —           | —                | 126         | —          | 126         |
| Utilities                                         | —                | 820     | —          | —      | —           | —                | 820         | —          | 820         |
| Other                                             | —                | 425     | —          | —      | —           | —                | 425         | —          | 425         |
| Total third party                                 | —                | 14,751  | —          | 18     | 21          | 281              | 15,071      | —          | 15,071      |
| Amounts due from holding company and subsidiaries | —                | 1,724   | —          | —      | —           | —                | 1,724       | —          | 1,724       |
| Total gross of provisions                         | —                | 16,475  | —          | 18     | 21          | 281              | 16,795      | —          | 16,795      |
| Provisions                                        | —                | (1,478) | —          | —      | —           | —                | (1,478)     | n/a        | (1,478)     |
| Total                                             | —                | 14,997  | —          | 18     | 21          | 281              | 15,317      | —          | 15,317      |
| <b>RoW</b>                                        |                  |         |            |        |             |                  |             |            |             |
| Central and local government                      | 117              | 79      | 4,379      | —      | 190         | —                | 4,765       | —          | 4,765       |
| Financial institutions - banks                    | 860              | 1,874   | —          | —      | 22,618      | 2,087            | 27,439      | (20,356)   | 7,083       |
| - other (2)                                       | 120              | 516     | 2,121      | —      | 5,655       | 34               | 8,446       | (7,383)    | 1,063       |
| Personal - mortgages                              | —                | 380     | —          | —      | —           | —                | 380         | —          | 380         |
| - unsecured                                       | —                | 1       | —          | —      | —           | —                | 1           | —          | 1           |
| Property & construction                           | —                | 698     | 270        | 14     | 62          | 1                | 1,045       | —          | 1,045       |
| Manufacturing                                     | —                | 412     | 4          | —      | 778         | 306              | 1,500       | —          | 1,500       |
| Finance leases and instalment credit              | —                | 37      | 127        | —      | —           | —                | 164         | —          | 164         |
| Retail, wholesale and repairs                     | —                | 288     | 3          | —      | 75          | —                | 366         | —          | 366         |
| Transport and storage                             | —                | 397     | 66         | —      | 147         | —                | 610         | —          | 610         |
| Health, education and leisure                     | —                | 581     | —          | —      | 32          | —                | 613         | —          | 613         |
| Hotels and restaurants                            | —                | 14      | —          | —      | —           | —                | 14          | —          | 14          |
| Utilities                                         | —                | 644     | —          | —      | 68          | —                | 712         | —          | 712         |
| Other                                             | —                | 589     | 11         | —      | 667         | —                | 1,267       | —          | 1,267       |
| Total third party                                 | 1,097            | 6,510   | 6,981      | 14     | 30,292      | 2,428            | 47,322      | (27,739)   | 19,583      |
| Amounts due from holding company and subsidiaries | —                | 5,128   | 616        | —      | 1,428       | —                | 7,172       | —          | 7,172       |
| Total gross of provisions                         | 1,097            | 11,638  | 7,597      | 14     | 31,720      | 2,428            | 54,494      | (27,739)   | 26,755      |
| Provisions                                        | —                | (282)   | (114)      | —      | —           | —                | (396)       | n/a        | (396)       |
| Total excluding disposal groups                   | 1,097            | 11,356  | 7,483      | 14     | 31,720      | 2,428            | 54,098      | (27,739)   | 26,359      |
| Disposal groups                                   | —                | 43      | —          | —      | —           | —                | 43          | —          | 43          |
| Total including disposal groups                   | 1,097            | 11,399  | 7,483      | 14     | 31,720      | 2,428            | 54,141      | (27,739)   | 26,402      |

#### Notes:

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

## Financial review *Risk and balance sheet management*

### Asset quality

The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings and are therefore excluded from the following tables. These are set out on pages 126 to 129.

| Asset quality band | Probability of default range |
|--------------------|------------------------------|
| AQ1                | 0% - 0.034%                  |
| AQ2                | 0.034% - 0.048%              |
| AQ3                | 0.048% - 0.095%              |
| AQ4                | 0.095% - 0.381%              |
| AQ5                | 0.381% - 1.076%              |
| AQ6                | 1.076% - 2.153%              |
| AQ7                | 2.153% - 6.089%              |
| AQ8                | 6.089% - 17.222%             |
| AQ9                | 17.222% - 100%               |
| AQ10               | 100%                         |

|                                                                | Group                                          |                        |                                        |             |             |                        |                                        |             |             |             |                                           |                   |                                 |             |
|----------------------------------------------------------------|------------------------------------------------|------------------------|----------------------------------------|-------------|-------------|------------------------|----------------------------------------|-------------|-------------|-------------|-------------------------------------------|-------------------|---------------------------------|-------------|
|                                                                | Loans and advances                             |                        |                                        |             |             |                        |                                        |             |             |             | Settlement                                |                   |                                 |             |
|                                                                | Cash and<br>balances at<br>central banks<br>£m | Banks (1)              |                                        |             |             | Customers              |                                        |             |             | Total<br>£m | balances and<br>other financial<br>assets |                   | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                                |                                                | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m |             | Derivatives<br>£m                         | Commitments<br>£m |                                 |             |
| 2013                                                           |                                                |                        |                                        |             |             |                        |                                        |             |             |             |                                           |                   |                                 |             |
| <b>Total</b>                                                   |                                                |                        |                                        |             |             |                        |                                        |             |             |             |                                           |                   |                                 |             |
| AQ1                                                            | 77,876                                         | 5,881                  | 1,948                                  | 5,456       | 13,285      | 30,233                 | 9,942                                  | 33,644      | 73,819      | 2,707       | 71,008                                    | 64,299            | 6,545                           | 309,539     |
| AQ2                                                            | 1                                              | 4,743                  | 4,830                                  | 527         | 10,100      | 996                    | 1,899                                  | 17,471      | 20,366      | 192         | 69,817                                    | 28,695            | 2,888                           | 132,059     |
| AQ3                                                            | 1,648                                          | 2,121                  | 1,141                                  | 2,157       | 5,419       | 1,857                  | 3,711                                  | 28,789      | 34,357      | 745         | 94,133                                    | 22,865            | 3,498                           | 162,665     |
| AQ4                                                            | 465                                            | 9,798                  | 1,384                                  | 6,161       | 17,343      | 10,642                 | 1,845                                  | 98,008      | 110,495     | 460         | 38,318                                    | 40,564            | 3,988                           | 211,633     |
| AQ5                                                            | —                                              | 1,774                  | 368                                    | 538         | 2,680       | 5,403                  | 271                                    | 76,476      | 82,150      | 717         | 8,807                                     | 33,380            | 1,908                           | 129,642     |
| AQ6                                                            | —                                              | 1,821                  | 1                                      | 152         | 1,974       | 82                     | 38                                     | 38,760      | 38,880      | 59          | 1,480                                     | 14,114            | 1,405                           | 57,912      |
| AQ7                                                            | —                                              | 301                    | —                                      | 237         | 538         | 684                    | 40                                     | 30,125      | 30,849      | 22          | 973                                       | 7,428             | 729                             | 40,539      |
| AQ8                                                            | 3                                              | —                      | —                                      | 45          | 45          | —                      | 10                                     | 8,383       | 8,393       | 58          | 132                                       | 1,170             | 100                             | 9,901       |
| AQ9                                                            | —                                              | —                      | —                                      | 34          | 34          | —                      | 41                                     | 16,488      | 16,529      | —           | 636                                       | 1,010             | 298                             | 18,507      |
| AQ10                                                           | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 721         | 721         | —           | 686                                       | 1,236             | 137                             | 2,780       |
| Balances with<br>holding company<br>and fellow<br>subsidiaries | —                                              | —                      | —                                      | 15,058      | 15,058      | —                      | —                                      | 1,620       | 1,620       | 54          | 3,413                                     | 34                | 797                             | 20,976      |
| Past due                                                       | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 9,068       | 9,068       | 620         | —                                         | —                 | —                               | 9,688       |
| Impaired                                                       | —                                              | —                      | —                                      | 69          | 69          | —                      | —                                      | 36,836      | 36,836      | —           | —                                         | —                 | —                               | 36,905      |
| Impairment<br>provision                                        | —                                              | —                      | —                                      | (62)        | (62)        | —                      | —                                      | (24,983)    | (24,983)    | —           | —                                         | —                 | —                               | (25,045)    |
| Total excluding<br>disposal groups                             | 79,993                                         | 26,439                 | 9,672                                  | 30,372      | 66,483      | 49,897                 | 17,797                                 | 371,406     | 439,100     | 5,634       | 289,403                                   | 214,795           | 22,293                          | 1,117,701   |
| Disposal groups                                                | —                                              | —                      | —                                      | 15          | 15          | —                      | —                                      | 689         | 689         | —           | 1                                         | —                 | —                               | 705         |
| Total including<br>disposal groups                             | 79,993                                         | 26,439                 | 9,672                                  | 30,387      | 66,498      | 49,897                 | 17,797                                 | 372,095     | 439,789     | 5,634       | 289,404                                   | 214,795           | 22,293                          | 1,118,406   |

For the notes to this table refer to page 119.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Asset quality continued

|                                                                | Group                                          |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
|----------------------------------------------------------------|------------------------------------------------|------------------------|----------------------------------------|-------------|-------------|------------------------|----------------------------------------|-------------|-------------|---------------------------------------------------------------|-------------------|-------------------|---------------------------------|-------------|
|                                                                | Cash and<br>balances at<br>central banks<br>£m | Loans and advances     |                                        |             |             |                        |                                        |             |             | Settlement<br>balances and<br>other financial<br>assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                                |                                                | Banks (1)              |                                        |             |             | Customers              |                                        |             |             |                                                               |                   |                   |                                 |             |
|                                                                |                                                | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m |                                                               |                   |                   |                                 |             |
| 2012                                                           |                                                |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
| Total                                                          |                                                |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
| AQ1                                                            | 73,643                                         | 17,600                 | 3,107                                  | 7,551       | 28,258      | 42,963                 | 14,822                                 | 38,389      | 96,174      | 1,911                                                         | 100,028           | 62,501            | 6,295                           | 368,810     |
| AQ2                                                            | 12                                             | 3,556                  | 4,351                                  | 494         | 8,401       | 710                    | 704                                    | 12,804      | 14,218      | 185                                                           | 108,092           | 19,260            | 2,455                           | 152,623     |
| AQ3                                                            | 839                                            | 5,703                  | 2,144                                  | 2,588       | 10,435      | 2,886                  | 3,801                                  | 23,268      | 29,955      | 539                                                           | 152,300           | 22,855            | 3,318                           | 220,241     |
| AQ4                                                            | 29                                             | 6,120                  | 1,509                                  | 2,333       | 9,962       | 14,079                 | 2,111                                  | 102,129     | 118,319     | 1,202                                                         | 56,917            | 39,589            | 5,119                           | 231,137     |
| AQ5                                                            | —                                              | 1,183                  | 403                                    | 632         | 2,218       | 8,163                  | 657                                    | 90,532      | 99,352      | 614                                                           | 12,909            | 28,049            | 2,469                           | 145,611     |
| AQ6                                                            | —                                              | 282                    | 39                                     | 356         | 677         | 86                     | 50                                     | 39,359      | 39,495      | 72                                                            | 2,165             | 13,762            | 1,271                           | 57,442      |
| AQ7                                                            | —                                              | —                      | —                                      | 113         | 113         | 1,133                  | 12                                     | 36,017      | 37,162      | 191                                                           | 3,193             | 18,790            | 856                             | 60,305      |
| AQ8                                                            | —                                              | —                      | —                                      | 28          | 28          | —                      | 2                                      | 12,653      | 12,655      | 8                                                             | 237               | 5,652             | 179                             | 18,759      |
| AQ9                                                            | 1                                              | —                      | —                                      | 80          | 80          | 23                     | 7                                      | 17,261      | 17,291      | —                                                             | 1,357             | 1,340             | 74                              | 20,143      |
| AQ10                                                           | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 760         | 760         | —                                                             | 703               | 1,402             | 236                             | 3,101       |
| Balances with<br>holding company<br>and fellow<br>subsidiaries | —                                              | —                      | —                                      | 21,875      | 21,875      | —                      | —                                      | 1,866       | 1,866       | —                                                             | 7,200             | 538               | 2,901                           | 34,380      |
| Past due                                                       | —                                              | —                      | —                                      | —           | —           | —                      | 249                                    | 10,281      | 10,530      | 995                                                           | —                 | —                 | —                               | 11,525      |
| Impaired                                                       | —                                              | —                      | —                                      | 133         | 133         | —                      | —                                      | 37,754      | 37,754      | —                                                             | —                 | —                 | —                               | 37,887      |
| Impairment<br>provision                                        | —                                              | —                      | —                                      | (113)       | (113)       | —                      | —                                      | (20,694)    | (20,694)    | —                                                             | —                 | —                 | —                               | (20,807)    |
| Total excluding<br>disposal groups                             | 74,524                                         | 34,444                 | 11,553                                 | 36,070      | 82,067      | 70,043                 | 22,415                                 | 402,379     | 494,837     | 5,717                                                         | 445,101           | 213,738           | 25,173                          | 1,341,157   |
| Disposal groups                                                | —                                              | —                      | —                                      | 20          | 20          | —                      | —                                      | 263         | 263         | —                                                             | 3                 | —                 | —                               | 286         |
| Total including<br>disposal groups                             | 74,524                                         | 34,444                 | 11,553                                 | 36,090      | 82,087      | 70,043                 | 22,415                                 | 402,642     | 495,100     | 5,717                                                         | 445,104           | 213,738           | 25,173                          | 1,341,443   |

|                                                          | Group                                          |                    |                 |                                                            |                   |                                    |                   |                                 |             |
|----------------------------------------------------------|------------------------------------------------|--------------------|-----------------|------------------------------------------------------------|-------------------|------------------------------------|-------------------|---------------------------------|-------------|
|                                                          | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                 | Settlement<br>balances and other<br>financial assets<br>£m | Derivatives<br>£m | Other<br>financial<br>assets<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                          |                                                | Banks (1)<br>£m    | Customers<br>£m |                                                            |                   |                                    |                   |                                 |             |
| 2011                                                     |                                                |                    |                 |                                                            |                   |                                    |                   |                                 |             |
| Total                                                    |                                                |                    |                 |                                                            |                   |                                    |                   |                                 |             |
| AQ1                                                      |                                                | 68,367             | 62,658          | 106,743                                                    | 4,277             | 477,729                            | 25                | 68,155                          | 794,842     |
| AQ2                                                      |                                                | 10                 | 1,601           | 13,468                                                     | 93                | 7,265                              | —                 | 20,758                          | 44,222      |
| AQ3                                                      |                                                | 23                 | 1,641           | 29,148                                                     | 32                | 9,863                              | —                 | 21,048                          | 63,796      |
| AQ4                                                      |                                                | 19                 | 1,272           | 97,569                                                     | 753               | 13,738                             | —                 | 36,958                          | 153,517     |
| AQ5                                                      |                                                | 44                 | 844             | 109,173                                                    | 41                | 6,129                              | —                 | 33,513                          | 152,485     |
| AQ6                                                      |                                                | 9                  | 117             | 46,165                                                     | 46                | 2,169                              | —                 | 16,833                          | 66,663      |
| AQ7                                                      |                                                | 8                  | 113             | 29,751                                                     | 12                | 2,309                              | —                 | 18,868                          | 51,664      |
| AQ8                                                      |                                                | 1                  | 14              | 11,568                                                     | 19                | 1,055                              | —                 | 4,142                           | 17,052      |
| AQ9                                                      |                                                | 5                  | 7               | 15,301                                                     | 4                 | 1,147                              | 7                 | 1,570                           | 18,145      |
| AQ10                                                     |                                                | 1                  | 162             | 391                                                        | 2                 | 1,023                              | —                 | 2,123                           | 3,901       |
| Balances with holding company<br>and fellow subsidiaries | —                                              | 27,232             | 792             | —                                                          | 10,380            | —                                  | 7                 | 5,753                           | 44,164      |
| Past due                                                 | —                                              | —                  | 10,779          | 1,623                                                      | —                 | —                                  | —                 | —                               | 12,402      |
| Impaired                                                 | —                                              | 94                 | 37,020          | —                                                          | —                 | —                                  | —                 | —                               | 37,114      |
| Impairment provision                                     | —                                              | (85)               | (18,469)        | —                                                          | —                 | —                                  | —                 | —                               | (18,554)    |
| Total excluding disposal groups                          |                                                | 68,487             | 95,670          | 489,399                                                    | 6,902             | 532,807                            | 32                | 223,975                         | 1,441,413   |
| Disposal groups                                          |                                                | 100                | 25              | 18,723                                                     | 14                | 439                                | 18                | —                               | 19,319      |
| Total including disposal groups                          |                                                | 68,587             | 95,695          | 508,122                                                    | 6,916             | 533,246                            | 50                | 223,975                         | 1,460,732   |

For the notes to these tables refer to page 119.

## Financial review *Risk and balance sheet management*

| 2013                                                           | Group                                          |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
|----------------------------------------------------------------|------------------------------------------------|------------------------|----------------------------------------|-------------|-------------|------------------------|----------------------------------------|-------------|-------------|---------------------------------------------------------------|-------------------|-------------------|---------------------------------|-------------|
|                                                                | Loans and advances                             |                        |                                        |             |             |                        |                                        |             |             | Settlement                                                    |                   |                   |                                 |             |
|                                                                | Cash and<br>balances at<br>central banks<br>£m | Banks (1)              |                                        |             |             | Customers              |                                        |             |             | Settlement<br>balances and<br>other financial<br>assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>Liabilities<br>£m | Total<br>£m |
|                                                                |                                                | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m |                                                               |                   |                   |                                 |             |
| Core                                                           |                                                |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
| AQ1                                                            | 77,846                                         | 5,881                  | 1,948                                  | 5,422       | 13,251      | 30,233                 | 9,942                                  | 31,382      | 71,557      | 2,706                                                         | 70,751            | 63,996            | 6,494                           | 306,601     |
| AQ2                                                            | —                                              | 4,743                  | 4,830                                  | 526         | 10,099      | 996                    | 1,899                                  | 17,144      | 20,039      | 192                                                           | 69,690            | 28,621            | 2,866                           | 131,507     |
| AQ3                                                            | 1,648                                          | 2,121                  | 1,141                                  | 2,001       | 5,263       | 1,857                  | 3,711                                  | 27,963      | 33,531      | 745                                                           | 93,775            | 22,747            | 3,480                           | 161,189     |
| AQ4                                                            | 406                                            | 9,798                  | 1,384                                  | 6,145       | 17,327      | 10,642                 | 1,845                                  | 94,734      | 107,221     | 438                                                           | 37,851            | 40,317            | 3,773                           | 207,333     |
| AQ5                                                            | —                                              | 1,774                  | 368                                    | 537         | 2,679       | 5,403                  | 271                                    | 74,763      | 80,437      | 717                                                           | 8,094             | 33,186            | 1,821                           | 126,934     |
| AQ6                                                            | —                                              | 1,821                  | 1                                      | 147         | 1,969       | 82                     | 38                                     | 36,961      | 37,081      | 59                                                            | 1,184             | 13,771            | 1,378                           | 55,442      |
| AQ7                                                            | —                                              | 301                    | —                                      | 204         | 505         | 677                    | 40                                     | 29,350      | 30,067      | 22                                                            | 751               | 7,151             | 724                             | 39,220      |
| AQ8                                                            | 3                                              | —                      | —                                      | 25          | 25          | —                      | 10                                     | 7,936       | 7,946       | 58                                                            | 95                | 1,073             | 99                              | 9,299       |
| AQ9                                                            | —                                              | —                      | —                                      | 23          | 23          | —                      | 41                                     | 12,420      | 12,461      | —                                                             | 476               | 687               | 264                             | 13,911      |
| AQ10                                                           | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 682         | 682         | —                                                             | 296               | 954               | 64                              | 1,996       |
| Balances with<br>holding company<br>and fellow<br>subsidiaries | —                                              | —                      | —                                      | 14,992      | 14,992      | —                      | —                                      | 1,620       | 1,620       | 54                                                            | 3,392             | 34                | 797                             | 20,889      |
| Past due                                                       | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 8,536       | 8,536       | 583                                                           | —                 | —                 | —                               | 9,119       |
| Impaired                                                       | —                                              | —                      | —                                      | 69          | 69          | —                      | —                                      | 18,317      | 18,317      | —                                                             | —                 | —                 | —                               | 18,386      |
| Impairment<br>provision                                        | —                                              | —                      | —                                      | (62)        | (62)        | —                      | —                                      | (11,287)    | (11,287)    | —                                                             | —                 | —                 | —                               | (11,349)    |
| Total excluding<br>disposal groups                             | 79,903                                         | 26,439                 | 9,672                                  | 30,029      | 66,140      | 49,890                 | 17,797                                 | 350,521     | 418,208     | 5,574                                                         | 286,355           | 212,537           | 21,760                          | 1,090,477   |
| Disposal groups                                                | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 652         | 652         | —                                                             | —                 | —                 | —                               | 652         |
| Total including<br>disposal groups                             | 79,903                                         | 26,439                 | 9,672                                  | 30,029      | 66,140      | 49,890                 | 17,797                                 | 351,173     | 418,860     | 5,574                                                         | 286,355           | 212,537           | 21,760                          | 1,091,129   |
| 2012                                                           |                                                |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
| Core                                                           |                                                |                        |                                        |             |             |                        |                                        |             |             |                                                               |                   |                   |                                 |             |
| AQ1                                                            | 73,615                                         | 17,600                 | 3,107                                  | 7,426       | 28,133      | 42,963                 | 14,822                                 | 31,740      | 89,525      | 1,911                                                         | 99,307            | 61,161            | 6,004                           | 359,656     |
| AQ2                                                            | 12                                             | 3,556                  | 4,351                                  | 494         | 8,401       | 710                    | 704                                    | 10,254      | 11,668      | 185                                                           | 107,633           | 19,134            | 2,437                           | 149,470     |
| AQ3                                                            | 839                                            | 5,703                  | 2,144                                  | 2,588       | 10,435      | 2,886                  | 3,801                                  | 20,766      | 27,453      | 539                                                           | 151,958           | 22,629            | 3,306                           | 217,159     |
| AQ4                                                            | 29                                             | 6,120                  | 1,509                                  | 2,333       | 9,962       | 14,079                 | 2,111                                  | 98,785      | 114,975     | 1,202                                                         | 55,911            | 39,230            | 5,031                           | 226,340     |
| AQ5                                                            | —                                              | 1,183                  | 403                                    | 632         | 2,218       | 8,163                  | 657                                    | 86,223      | 95,043      | 614                                                           | 11,883            | 27,386            | 2,392                           | 139,536     |
| AQ6                                                            | —                                              | 282                    | 39                                     | 356         | 677         | 86                     | 50                                     | 36,544      | 36,680      | 72                                                            | 1,467             | 13,100            | 1,244                           | 53,240      |
| AQ7                                                            | —                                              | —                      | —                                      | 74          | 74          | 1,133                  | 12                                     | 31,952      | 33,097      | 191                                                           | 2,524             | 17,511            | 844                             | 54,241      |
| AQ8                                                            | —                                              | —                      | —                                      | 28          | 28          | —                      | 2                                      | 10,667      | 10,669      | 8                                                             | 231               | 5,573             | 144                             | 16,653      |
| AQ9                                                            | 1                                              | —                      | —                                      | 80          | 80          | —                      | 7                                      | 14,933      | 14,940      | —                                                             | 977               | 1,065             | 72                              | 17,135      |
| AQ10                                                           | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 667         | 667         | —                                                             | 379               | 808               | 148                             | 2,002       |
| Balances with<br>holding company<br>and fellow<br>subsidiaries | —                                              | —                      | —                                      | 21,841      | 21,841      | —                      | —                                      | 1,852       | 1,852       | —                                                             | 7,118             | 538               | 2,901                           | 34,250      |
| Past due                                                       | —                                              | —                      | —                                      | —           | —           | —                      | 249                                    | 9,527       | 9,776       | 991                                                           | —                 | —                 | —                               | 10,767      |
| Impaired                                                       | —                                              | —                      | —                                      | 133         | 133         | —                      | —                                      | 17,353      | 17,353      | —                                                             | —                 | —                 | —                               | 17,486      |
| Impairment<br>provision                                        | —                                              | —                      | —                                      | (113)       | (113)       | —                      | —                                      | (9,889)     | (9,889)     | —                                                             | —                 | —                 | —                               | (10,002)    |
| Total                                                          | 74,496                                         | 34,444                 | 11,553                                 | 35,872      | 81,869      | 70,020                 | 22,415                                 | 361,374     | 453,809     | 5,713                                                         | 439,388           | 208,135           | 24,523                          | 1,287,933   |

For the notes to these tables refer to page 119.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued Asset quality continued

| 2011                                                     | Group                                          |                    |                 |                                                            |                   |                                    |                   |                                 |             |
|----------------------------------------------------------|------------------------------------------------|--------------------|-----------------|------------------------------------------------------------|-------------------|------------------------------------|-------------------|---------------------------------|-------------|
|                                                          | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                 | Settlement<br>balances and other<br>financial assets<br>£m | Derivatives<br>£m | Other<br>financial<br>assets<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                          |                                                | Banks (1)<br>£m    | Customers<br>£m |                                                            |                   |                                    |                   |                                 |             |
| <b>Core</b>                                              |                                                |                    |                 |                                                            |                   |                                    |                   |                                 |             |
| AQ1                                                      | 68,317                                         | 62,614             | 89,622          | 4,271                                                      | 473,991           | 25                                 | 62,330            | 6,254                           | 767,424     |
| AQ2                                                      | 10                                             | 1,601              | 12,051          | 91                                                         | 6,740             | —                                  | 19,834            | 1,024                           | 41,351      |
| AQ3                                                      | 22                                             | 1,641              | 26,518          | 32                                                         | 9,406             | —                                  | 19,960            | 1,997                           | 59,576      |
| AQ4                                                      | 18                                             | 1,272              | 92,385          | 752                                                        | 12,795            | —                                  | 35,885            | 3,083                           | 146,190     |
| AQ5                                                      | 44                                             | 844                | 102,666         | 41                                                         | 4,701             | —                                  | 32,380            | 2,573                           | 143,249     |
| AQ6                                                      | 9                                              | 117                | 40,438          | 46                                                         | 1,936             | —                                  | 15,950            | 1,322                           | 59,818      |
| AQ7                                                      | 8                                              | 113                | 25,964          | 12                                                         | 712               | —                                  | 17,285            | 530                             | 44,624      |
| AQ8                                                      | 1                                              | 14                 | 9,730           | 19                                                         | 584               | —                                  | 4,057             | 216                             | 14,621      |
| AQ9                                                      | 5                                              | 7                  | 10,999          | 4                                                          | 589               | 7                                  | 1,416             | 80                              | 13,107      |
| AQ10                                                     | 1                                              | 162                | 229             | 2                                                          | 315               | —                                  | 1,193             | 163                             | 2,065       |
| Balances with holding company<br>and fellow subsidiaries | —                                              | 27,196             | 764             | —                                                          | 10,084            | —                                  | 7                 | 5,753                           | 43,804      |
| Past due                                                 | —                                              | —                  | 9,299           | 1,623                                                      | —                 | —                                  | —                 | —                               | 10,922      |
| Impaired                                                 | —                                              | 94                 | 14,497          | —                                                          | —                 | —                                  | —                 | —                               | 14,591      |
| Impairment provision                                     | —                                              | (85)               | (7,666)         | —                                                          | —                 | —                                  | —                 | —                               | (7,751)     |
| Total excluding disposal groups                          | 68,435                                         | 95,590             | 427,496         | 6,893                                                      | 521,853           | 32                                 | 210,297           | 22,995                          | 1,353,591   |
| Disposal groups                                          | 100                                            | —                  | 18,676          | —                                                          | 431               | 18                                 | —                 | —                               | 19,225      |
| Total including disposal groups                          | 68,535                                         | 95,590             | 446,172         | 6,893                                                      | 522,284           | 50                                 | 210,297           | 22,995                          | 1,372,816   |

|                                                                | Group                                          |                    |           |                        |             |                                                               |                   |                   |                                 |             |
|----------------------------------------------------------------|------------------------------------------------|--------------------|-----------|------------------------|-------------|---------------------------------------------------------------|-------------------|-------------------|---------------------------------|-------------|
|                                                                | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |           |                        |             | Settlement<br>balances and<br>other financial<br>assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                                |                                                | Banks<br>£m        | Customers |                        | Total<br>£m |                                                               |                   |                   |                                 |             |
|                                                                |                                                |                    |           | Reverse<br>repos<br>£m |             | Other<br>£m                                                   |                   |                   |                                 |             |
| 2013                                                           |                                                |                    |           |                        |             |                                                               |                   |                   |                                 |             |
| Non-Core                                                       |                                                |                    |           |                        |             |                                                               |                   |                   |                                 |             |
| AQ1                                                            | 30                                             | 34                 | —         | 2,262                  | 2,262       | 1                                                             | 257               | 303               | 51                              | 2,938       |
| AQ2                                                            | 1                                              | 1                  | —         | 327                    | 327         | —                                                             | 127               | 74                | 22                              | 552         |
| AQ3                                                            | —                                              | 156                | —         | 826                    | 826         | —                                                             | 358               | 118               | 18                              | 1,476       |
| AQ4                                                            | 59                                             | 16                 | —         | 3,274                  | 3,274       | 22                                                            | 467               | 247               | 215                             | 4,300       |
| AQ5                                                            | —                                              | 1                  | —         | 1,713                  | 1,713       | —                                                             | 713               | 194               | 87                              | 2,708       |
| AQ6                                                            | —                                              | 5                  | —         | 1,799                  | 1,799       | —                                                             | 296               | 343               | 27                              | 2,470       |
| AQ7                                                            | —                                              | 33                 | 7         | 775                    | 782         | —                                                             | 222               | 277               | 5                               | 1,319       |
| AQ8                                                            | —                                              | 20                 | —         | 447                    | 447         | —                                                             | 37                | 97                | 1                               | 602         |
| AQ9                                                            | —                                              | 11                 | —         | 4,068                  | 4,068       | —                                                             | 160               | 323               | 34                              | 4,596       |
| AQ10                                                           | —                                              | —                  | —         | 39                     | 39          | —                                                             | 390               | 282               | 73                              | 784         |
| Balances with<br>holding company<br>and fellow<br>subsidiaries | —                                              | 66                 | —         | —                      | —           | —                                                             | 21                | —                 | —                               | 87          |
| Past due                                                       | —                                              | —                  | —         | 532                    | 532         | 37                                                            | —                 | —                 | —                               | 569         |
| Impaired                                                       | —                                              | —                  | —         | 18,519                 | 18,519      | —                                                             | —                 | —                 | —                               | 18,519      |
| Impairment<br>provision                                        | —                                              | —                  | —         | (13,696)               | (13,696)    | —                                                             | —                 | —                 | —                               | (13,696)    |
| Total excluding<br>disposal groups                             | 90                                             | 343                | 7         | 20,885                 | 20,892      | 60                                                            | 3,048             | 2,258             | 533                             | 27,224      |
| Disposal groups                                                | —                                              | 15                 | —         | 37                     | 37          | —                                                             | 1                 | —                 | —                               | 53          |
| Total including<br>disposal groups                             | 90                                             | 358                | 7         | 20,922                 | 20,929      | 60                                                            | 3,049             | 2,258             | 533                             | 27,277      |

For the notes to these tables refer to page 119.

## Financial review *Risk and balance sheet management*

| 2012                                                     | Group                                          |                    |                        |             |             |                                                               |                   |                   |                                 |             |
|----------------------------------------------------------|------------------------------------------------|--------------------|------------------------|-------------|-------------|---------------------------------------------------------------|-------------------|-------------------|---------------------------------|-------------|
|                                                          | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                        |             |             | Settlement<br>balances and<br>other financial<br>assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                          |                                                | Customers          |                        |             |             |                                                               |                   |                   |                                 |             |
|                                                          |                                                | Banks<br>£m        | Reverse<br>repos<br>£m | Other<br>£m | Total<br>£m |                                                               |                   |                   |                                 |             |
| Non-Core                                                 |                                                |                    |                        |             |             |                                                               |                   |                   |                                 |             |
| AQ1                                                      | 28                                             | 125                | —                      | 6,649       | 6,649       | —                                                             | 721               | 1,340             | 291                             | 9,154       |
| AQ2                                                      | —                                              | —                  | —                      | 2,550       | 2,550       | —                                                             | 459               | 126               | 18                              | 3,153       |
| AQ3                                                      | —                                              | —                  | —                      | 2,502       | 2,502       | —                                                             | 342               | 226               | 12                              | 3,082       |
| AQ4                                                      | —                                              | —                  | —                      | 3,344       | 3,344       | —                                                             | 1,006             | 359               | 88                              | 4,797       |
| AQ5                                                      | —                                              | —                  | —                      | 4,309       | 4,309       | —                                                             | 1,026             | 663               | 77                              | 6,075       |
| AQ6                                                      | —                                              | —                  | —                      | 2,815       | 2,815       | —                                                             | 698               | 662               | 27                              | 4,202       |
| AQ7                                                      | —                                              | 39                 | —                      | 4,065       | 4,065       | —                                                             | 669               | 1,279             | 12                              | 6,064       |
| AQ8                                                      | —                                              | —                  | —                      | 1,986       | 1,986       | —                                                             | 6                 | 79                | 35                              | 2,106       |
| AQ9                                                      | —                                              | —                  | 23                     | 2,328       | 2,351       | —                                                             | 380               | 275               | 2                               | 3,008       |
| AQ10                                                     | —                                              | —                  | —                      | 93          | 93          | —                                                             | 324               | 594               | 88                              | 1,099       |
| Balances with holding company<br>and fellow subsidiaries | —                                              | 34                 | —                      | 14          | 14          | —                                                             | 82                | —                 | —                               | 130         |
| Past due                                                 | —                                              | —                  | —                      | 754         | 754         | 4                                                             | —                 | —                 | —                               | 758         |
| Impaired                                                 | —                                              | —                  | —                      | 20,401      | 20,401      | —                                                             | —                 | —                 | —                               | 20,401      |
| Impairment<br>provision                                  | —                                              | —                  | —                      | (10,805)    | (10,805)    | —                                                             | —                 | —                 | —                               | (10,805)    |
| Total excluding<br>disposal groups                       | 28                                             | 198                | 23                     | 41,005      | 41,028      | 4                                                             | 5,713             | 5,603             | 650                             | 53,224      |
| Disposal groups                                          | —                                              | 20                 | —                      | 263         | 263         | —                                                             | 3                 | —                 | —                               | 286         |
| Total including<br>disposal groups                       | 28                                             | 218                | 23                     | 41,268      | 41,291      | 4                                                             | 5,716             | 5,603             | 650                             | 53,510      |

|                                                          | Group                                          |                    |                 |                                                            |                   |                                    |                   |                                 |             |
|----------------------------------------------------------|------------------------------------------------|--------------------|-----------------|------------------------------------------------------------|-------------------|------------------------------------|-------------------|---------------------------------|-------------|
|                                                          | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                 | Settlement<br>balances and other<br>financial assets<br>£m | Derivatives<br>£m | Other<br>financial<br>assets<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
| 2011                                                     |                                                | Banks (1)<br>£m    | Customers<br>£m |                                                            |                   |                                    |                   |                                 |             |
| Non-Core                                                 |                                                |                    |                 |                                                            |                   |                                    |                   |                                 |             |
| AQ1                                                      | 50                                             | 44                 | 17,121          | 6                                                          | 3,738             | —                                  | 5,825             | 634                             | 27,418      |
| AQ2                                                      | —                                              | —                  | 1,417           | 2                                                          | 525               | —                                  | 924               | 3                               | 2,871       |
| AQ3                                                      | 1                                              | —                  | 2,630           | —                                                          | 457               | —                                  | 1,088             | 44                              | 4,220       |
| AQ4                                                      | 1                                              | —                  | 5,184           | 1                                                          | 943               | —                                  | 1,073             | 125                             | 7,327       |
| AQ5                                                      | —                                              | —                  | 6,507           | —                                                          | 1,428             | —                                  | 1,133             | 168                             | 9,236       |
| AQ6                                                      | —                                              | —                  | 5,727           | —                                                          | 233               | —                                  | 883               | 2                               | 6,845       |
| AQ7                                                      | —                                              | —                  | 3,787           | —                                                          | 1,597             | —                                  | 1,583             | 73                              | 7,040       |
| AQ8                                                      | —                                              | —                  | 1,838           | —                                                          | 471               | —                                  | 85                | 37                              | 2,431       |
| AQ9                                                      | —                                              | —                  | 4,302           | —                                                          | 558               | —                                  | 154               | 24                              | 5,038       |
| AQ10                                                     | —                                              | —                  | 162             | —                                                          | 708               | —                                  | 930               | 36                              | 1,836       |
| Balances with holding company<br>and fellow subsidiaries | —                                              | 36                 | 28              | —                                                          | 296               | —                                  | —                 | —                               | 360         |
| Past due                                                 | —                                              | —                  | 1,480           | —                                                          | —                 | —                                  | —                 | —                               | 1,480       |
| Impaired                                                 | —                                              | —                  | 22,523          | —                                                          | —                 | —                                  | —                 | —                               | 22,523      |
| Impairment provision                                     | —                                              | —                  | (10,803)        | —                                                          | —                 | —                                  | —                 | —                               | (10,803)    |
| Total excluding disposal groups                          | 52                                             | 80                 | 61,903          | 9                                                          | 10,954            | —                                  | 13,678            | 1,146                           | 87,822      |
| Disposal groups                                          | —                                              | 25                 | 47              | 14                                                         | 8                 | —                                  | —                 | —                               | 94          |
| Total including disposal groups                          | 52                                             | 105                | 61,950          | 23                                                         | 10,962            | —                                  | 13,678            | 1,146                           | 87,916      |

### Notes:

- (1) Excluding items in the course of collection from other banks of £1,454 million (2012 - £1,531 million; 2011 - £1,470 million).
- (2) Exposures are allocated to asset quality bands on the basis of statistically driven models which produce an estimate of default rate. The variables included in the models vary by product and geography. For portfolios secured on residential property these models typically include measures of delinquency and loan-to-value as well as other differentiating characteristics such as bureau score, product features or associated account performance information.



## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Asset quality continued

##### Key points

- Underlying the balance sheet reduction in the year the overall asset quality in the upper bands (AQ1-AQ5) remained broadly similar.
- Within cash and balances at central banks there has been an increase in AQ1 of £4.2 billion due to additional funds deposited with the Bank of England and the Federal Reserve. Additionally, increases of £1.2 billion in AQ3 and AQ4 are due to deposits with other central banks as part of the Group's overall liquidity management.
- Third party reverse repo balances decreased £28.2 billion due to reduced trading volumes within Markets. However, AQ2 and AQ4-AQ7 have increased £7.3 billion in reverse repurchase agreements with banks as a small number of counterparties moved bands, in addition to the implementation of a strategy to develop relationships with newer, lower-rated counterparties.
- Derivatives decreased across all asset quality bands reflecting risk reduction within Markets.
- Core customer lending (third party) in AQ1-AQ3 increased to 22% from 18% at 31 December 2012 as recalibration of the UK Retail models using updated data trends from the last three years resulted in £9.8 billion moving from AQ5 to higher bands. In addition, mid corporate model updates in UK Corporate and data quality improvements in Wealth also led to improving trends.
- Core past due loans to customers (third party) decreased £1.2 billion, with a reduction in Ulster (£0.8 billion) and US Retail and Commercial (£1.2 billion) being offset by increases in UK Retail (£1.2 billion) as balances transferred from the impaired book.
- Impairment provisions increased £4.2 billion, mainly due to RCR and related change in strategy (£4.5 billion) partly offset by a decrease in UK Retail (£0.5 billion).

|                                                         | Bank                                           |                        |                                        |             |             |                        |                                        |             |             |              |                   |                   |                                 |             |
|---------------------------------------------------------|------------------------------------------------|------------------------|----------------------------------------|-------------|-------------|------------------------|----------------------------------------|-------------|-------------|--------------|-------------------|-------------------|---------------------------------|-------------|
|                                                         | Loans and advances                             |                        |                                        |             |             |                        |                                        |             |             | Settlement   |                   |                   |                                 |             |
|                                                         | Cash and<br>balances at<br>central banks<br>£m | Banks (1)              |                                        |             |             | Customers              |                                        |             |             | assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m |
|                                                         |                                                | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m | Reverse<br>repos<br>£m | Derivative<br>cash<br>collateral<br>£m | Other<br>£m | Total<br>£m |              |                   |                   |                                 |             |
| 2013                                                    |                                                |                        |                                        |             |             |                        |                                        |             |             |              |                   |                   |                                 |             |
| Total                                                   |                                                |                        |                                        |             |             |                        |                                        |             |             |              |                   |                   |                                 |             |
| AQ1                                                     | 74,071                                         | 1,935                  | 1,326                                  | 2,245       | 5,506       | 12,464                 | 9,942                                  | 12,537      | 34,943      | 1,285        | 70,456            | 49,213            | 5,839                           | 241,313     |
| AQ2                                                     | —                                              | 4,742                  | 4,830                                  | 438         | 10,010      | 716                    | 1,899                                  | 8,328       | 10,943      | 88           | 69,700            | 19,079            | 2,295                           | 112,115     |
| AQ3                                                     | 1,530                                          | 2,121                  | 1,141                                  | 709         | 3,971       | 1,464                  | 3,711                                  | 12,747      | 17,922      | 588          | 94,084            | 17,587            | 2,673                           | 138,355     |
| AQ4                                                     | 188                                            | 6,703                  | 1,384                                  | 4,431       | 12,518      | 7,086                  | 1,845                                  | 32,124      | 41,055      | 352          | 37,955            | 20,713            | 2,775                           | 115,556     |
| AQ5                                                     | —                                              | 1,719                  | 368                                    | 410         | 2,497       | 2,188                  | 271                                    | 29,686      | 32,145      | 490          | 8,421             | 12,390            | 897                             | 56,840      |
| AQ6                                                     | —                                              | 1,821                  | 1                                      | 56          | 1,878       | 59                     | 38                                     | 12,565      | 12,662      | —            | 1,265             | 4,554             | 664                             | 21,023      |
| AQ7                                                     | —                                              | 70                     | —                                      | 177         | 247         | 674                    | 40                                     | 9,624       | 10,338      | 22           | 793               | 2,758             | 335                             | 14,493      |
| AQ8                                                     | 3                                              | —                      | —                                      | 7           | 7           | —                      | 10                                     | 3,062       | 3,072       | 46           | 65                | 250               | 16                              | 3,459       |
| AQ9                                                     | —                                              | —                      | —                                      | 17          | 17          | —                      | 41                                     | 4,930       | 4,971       | —            | 560               | 330               | 156                             | 6,034       |
| AQ10                                                    | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 297         | 297         | —            | 614               | 607               | 126                             | 1,644       |
| Balances<br>with holding<br>company and<br>subsidiaries | —                                              | —                      | —                                      | 41,110      | 41,110      | —                      | —                                      | 49,945      | 49,945      | 290          | 8,967             | 5,046             | 797                             | 106,155     |
| Past due                                                | —                                              | —                      | —                                      | —           | —           | —                      | —                                      | 1,902       | 1,902       | 331          | —                 | —                 | —                               | 2,233       |
| Impaired                                                | —                                              | —                      | —                                      | 69          | 69          | —                      | —                                      | 11,353      | 11,353      | —            | —                 | —                 | —                               | 11,422      |
| Impairment<br>provision                                 | —                                              | —                      | —                                      | (62)        | (62)        | —                      | —                                      | (6,174)     | (6,174)     | —            | —                 | —                 | —                               | (6,236)     |
| Total                                                   | 75,792                                         | 19,111                 | 9,050                                  | 49,607      | 77,768      | 24,651                 | 17,797                                 | 182,926     | 225,374     | 3,492        | 292,880           | 132,527           | 16,573                          | 824,406     |

For the notes to this table refer to page 124.

## Financial review *Risk and balance sheet management*

| 2012                                                    | Bank                                     |                    |                                  |        |         |                  |                                  |         |         |                                                         |             |             |                           |           |
|---------------------------------------------------------|------------------------------------------|--------------------|----------------------------------|--------|---------|------------------|----------------------------------|---------|---------|---------------------------------------------------------|-------------|-------------|---------------------------|-----------|
|                                                         | Cash and<br>balances at<br>central banks | Loans and advances |                                  |        |         |                  |                                  |         |         | Settlement<br>balances and<br>other financial<br>assets | Derivatives | Commitments | Contingent<br>liabilities | Total     |
|                                                         |                                          | Banks (1)          |                                  |        |         | Customers        |                                  |         |         |                                                         |             |             |                           |           |
|                                                         |                                          | Reverse<br>repos   | Derivative<br>cash<br>collateral | Other  | Total   | Reverse<br>repos | Derivative<br>cash<br>collateral | Other   | Total   |                                                         |             |             |                           |           |
| £m                                                      | £m                                       | £m                 | £m                               | £m     | £m      | £m               | £m                               | £m      | £m      | £m                                                      | £m          | £m          | £m                        |           |
| Total                                                   |                                          |                    |                                  |        |         |                  |                                  |         |         |                                                         |             |             |                           |           |
| AQ1                                                     | 69,498                                   | 9,956              | 3,107                            | 3,619  | 16,682  | 27,334           | 14,822                           | 16,072  | 58,228  | 979                                                     | 99,307      | 50,040      | 5,585                     | 300,319   |
| AQ2                                                     | 12                                       | 3,556              | 4,351                            | 466    | 8,373   | 700              | 704                              | 6,542   | 7,946   | 4                                                       | 107,908     | 16,396      | 2,255                     | 142,894   |
| AQ3                                                     | 836                                      | 4,676              | 2,142                            | 928    | 7,746   | 2,221            | 3,801                            | 12,202  | 18,224  | 536                                                     | 152,178     | 18,143      | 2,793                     | 200,456   |
| AQ4                                                     | 28                                       | 5,941              | 1,503                            | 874    | 8,318   | 8,696            | 2,111                            | 34,550  | 45,357  | 918                                                     | 56,644      | 20,557      | 3,285                     | 135,107   |
| AQ5                                                     | —                                        | 1,183              | 403                              | 503    | 2,089   | 2,919            | 657                              | 37,358  | 40,934  | 243                                                     | 12,243      | 11,044      | 1,249                     | 67,802    |
| AQ6                                                     | —                                        | 282                | 39                               | 252    | 573     | 13               | 50                               | 13,685  | 13,748  | 63                                                      | 1,800       | 3,934       | 593                       | 20,711    |
| AQ7                                                     | —                                        | —                  | —                                | 57     | 57      | 1,089            | 12                               | 12,323  | 13,424  | 173                                                     | 2,943       | 7,956       | 496                       | 25,049    |
| AQ8                                                     | —                                        | —                  | —                                | 8      | 8       | —                | 2                                | 4,149   | 4,151   | —                                                       | 76          | 2,027       | 63                        | 6,325     |
| AQ9                                                     | —                                        | —                  | —                                | 35     | 35      | 23               | 7                                | 4,545   | 4,575   | —                                                       | 1,162       | 541         | 20                        | 6,333     |
| AQ10                                                    | —                                        | —                  | —                                | —      | —       | —                | —                                | 413     | 413     | —                                                       | 624         | 771         | 131                       | 1,939     |
| Balances<br>with holding<br>company<br>and subsidiaries | —                                        | —                  | —                                | 65,671 | 65,671  | —                | —                                | 55,468  | 55,468  | —                                                       | 14,953      | 5,515       | 2,901                     | 144,508   |
| Past due                                                | —                                        | —                  | —                                | —      | —       | —                | 249                              | 2,030   | 2,279   | 174                                                     | —           | —           | —                         | 2,453     |
| Impaired                                                | —                                        | —                  | —                                | 127    | 127     | —                | —                                | 12,320  | 12,320  | —                                                       | —           | —           | —                         | 12,447    |
| Impairment<br>provision                                 | —                                        | —                  | —                                | (108)  | (108)   | —                | —                                | (5,518) | (5,518) | —                                                       | —           | —           | —                         | (5,626)   |
| Total                                                   | 70,374                                   | 25,594             | 11,545                           | 72,432 | 109,571 | 42,995           | 22,415                           | 206,139 | 271,549 | 3,090                                                   | 449,838     | 136,924     | 19,371                    | 1,060,717 |

| 2011                                              | Bank                                     |                    |           |                                                      |             |             |                           |           | Total |
|---------------------------------------------------|------------------------------------------|--------------------|-----------|------------------------------------------------------|-------------|-------------|---------------------------|-----------|-------|
|                                                   | Cash and<br>balances at<br>central banks | Loans and advances |           | Settlement<br>balances and other<br>financial assets | Derivatives | Commitments | Contingent<br>liabilities |           |       |
|                                                   |                                          | Banks (1)          | Customers |                                                      |             |             |                           |           |       |
| Total                                             | £m                                       | £m                 | £m        | £m                                                   | £m          | £m          | £m                        | £m        |       |
| AQ1                                               | 64,147                                   | 44,919             | 58,622    | 3,227                                                | 476,718     | 49,260      | 6,089                     | 702,982   |       |
| AQ2                                               | 9                                        | 1,123              | 6,738     | 43                                                   | 7,085       | 19,358      | 747                       | 35,103    |       |
| AQ3                                               | 23                                       | 1,521              | 18,716    | 9                                                    | 9,798       | 17,272      | 1,631                     | 48,970    |       |
| AQ4                                               | 18                                       | 1,163              | 35,037    | 722                                                  | 13,432      | 19,993      | 1,223                     | 71,588    |       |
| AQ5                                               | 43                                       | 649                | 46,090    | 22                                                   | 5,335       | 12,829      | 1,108                     | 66,076    |       |
| AQ6                                               | 8                                        | 106                | 14,489    | 3                                                    | 1,678       | 5,728       | 357                       | 22,369    |       |
| AQ7                                               | 7                                        | 87                 | 7,424     | 11                                                   | 2,053       | 8,427       | 234                       | 18,243    |       |
| AQ8                                               | 1                                        | 9                  | 3,073     | 19                                                   | 865         | 1,206       | 59                        | 5,232     |       |
| AQ9                                               | 5                                        | 7                  | 5,899     | 3                                                    | 977         | 630         | 38                        | 7,559     |       |
| AQ10                                              | —                                        | 159                | 136       | —                                                    | 899         | 1,093       | 30                        | 2,317     |       |
| Balances with holding company<br>and subsidiaries | —                                        | 58,972             | 145,757   | —                                                    | 18,457      | 9,735       | 5,753                     | 238,674   |       |
| Past due                                          | —                                        | —                  | 1,474     | —                                                    | —           | —           | —                         | 1,474     |       |
| Impaired                                          | —                                        | 85                 | 12,215    | —                                                    | —           | —           | —                         | 12,300    |       |
| Impairment provision                              | —                                        | (76)               | (4,547)   | —                                                    | —           | —           | —                         | (4,623)   |       |
| Total excluding disposal groups                   | 64,261                                   | 108,724            | 351,123   | 4,059                                                | 537,297     | 145,531     | 17,269                    | 1,228,264 |       |
| Disposal groups                                   | 94                                       | 1                  | 18,110    | —                                                    | 414         | —           | —                         | 18,619    |       |
| Total including disposal groups                   | 64,355                                   | 108,725            | 369,233   | 4,059                                                | 537,711     | 145,531     | 17,269                    | 1,246,883 |       |

For the notes to these tables refer to page 124.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Asset quality continued

|                                                         | Bank                                     |                  |                                  |               |                |                  |                                  |                |                |              |                                 |                |                           |                  |
|---------------------------------------------------------|------------------------------------------|------------------|----------------------------------|---------------|----------------|------------------|----------------------------------|----------------|----------------|--------------|---------------------------------|----------------|---------------------------|------------------|
|                                                         | Loans and advances                       |                  |                                  |               |                |                  |                                  |                |                |              | Settlement                      |                |                           |                  |
|                                                         | Cash and<br>balances at<br>central banks | Banks (1)        |                                  |               |                | Customers        |                                  |                |                | Total        | balances and<br>other financial |                | Contingent<br>liabilities | Total            |
|                                                         |                                          | Reverse<br>repos | Derivative<br>cash<br>collateral | Other         | Total          | Reverse<br>repos | Derivative<br>cash<br>collateral | Other          | Total          |              | assets                          | Derivatives    |                           |                  |
| 2013                                                    | £m                                       | £m               | £m                               | £m            | £m             | £m               | £m                               | £m             | £m             | £m           | £m                              | £m             | £m                        | £m               |
| <b>Core</b>                                             |                                          |                  |                                  |               |                |                  |                                  |                |                |              |                                 |                |                           |                  |
| AQ1                                                     | 74,062                                   | 1,935            | 1,326                            | 2,245         | 5,506          | 12,464           | 9,942                            | 12,319         | 34,725         | 1,284        | 70,229                          | 49,061         | 5,815                     | 240,682          |
| AQ2                                                     | —                                        | 4,742            | 4,830                            | 438           | 10,010         | 716              | 1,899                            | 8,185          | 10,800         | 88           | 69,573                          | 19,036         | 2,273                     | 111,780          |
| AQ3                                                     | 1,530                                    | 2,121            | 1,141                            | 709           | 3,971          | 1,464            | 3,711                            | 12,534         | 17,709         | 588          | 93,726                          | 17,485         | 2,655                     | 137,664          |
| AQ4                                                     | 129                                      | 6,703            | 1,384                            | 4,421         | 12,508         | 7,086            | 1,845                            | 31,157         | 40,088         | 330          | 37,511                          | 20,518         | 2,564                     | 113,648          |
| AQ5                                                     | —                                        | 1,719            | 368                              | 410           | 2,497          | 2,188            | 271                              | 28,698         | 31,157         | 490          | 7,714                           | 12,256         | 813                       | 54,927           |
| AQ6                                                     | —                                        | 1,821            | 1                                | 53            | 1,875          | 59               | 38                               | 11,291         | 11,388         | —            | 969                             | 4,314          | 640                       | 19,186           |
| AQ7                                                     | —                                        | 70               | —                                | 144           | 214            | 674              | 40                               | 9,174          | 9,888          | 22           | 573                             | 2,620          | 331                       | 13,648           |
| AQ8                                                     | 3                                        | —                | —                                | 7             | 7              | —                | 10                               | 2,702          | 2,712          | 46           | 29                              | 216            | 15                        | 3,028            |
| AQ9                                                     | —                                        | —                | —                                | 17            | 17             | —                | 41                               | 2,298          | 2,339          | —            | 438                             | 267            | 155                       | 3,216            |
| AQ10                                                    | —                                        | —                | —                                | —             | —              | —                | —                                | 267            | 267            | —            | 234                             | 488            | 54                        | 1,043            |
| Balances<br>with holding<br>company and<br>subsidiaries | —                                        | —                | —                                | 40,956        | 40,956         | —                | —                                | 48,295         | 48,295         | 290          | 8,807                           | 5,046          | 797                       | 104,191          |
| Past due                                                | —                                        | —                | —                                | —             | —              | —                | —                                | 1,880          | 1,880          | 294          | —                               | —              | —                         | 2,174            |
| Impaired                                                | —                                        | —                | —                                | 69            | 69             | —                | —                                | 4,907          | 4,907          | —            | —                               | —              | —                         | 4,976            |
| Impairment<br>provision                                 | —                                        | —                | —                                | (62)          | (62)           | —                | —                                | (2,803)        | (2,803)        | —            | —                               | —              | —                         | (2,865)          |
| <b>Total</b>                                            | <b>75,724</b>                            | <b>19,111</b>    | <b>9,050</b>                     | <b>49,407</b> | <b>77,568</b>  | <b>24,651</b>    | <b>17,797</b>                    | <b>170,904</b> | <b>213,352</b> | <b>3,432</b> | <b>289,803</b>                  | <b>131,307</b> | <b>16,112</b>             | <b>807,298</b>   |
| <b>2012</b>                                             |                                          |                  |                                  |               |                |                  |                                  |                |                |              |                                 |                |                           |                  |
| <b>Core</b>                                             |                                          |                  |                                  |               |                |                  |                                  |                |                |              |                                 |                |                           |                  |
| AQ1                                                     | 69,498                                   | 9,956            | 3,107                            | 3,597         | 16,660         | 27,334           | 14,822                           | 13,262         | 55,418         | 979          | 98,646                          | 49,443         | 5,290                     | 295,934          |
| AQ2                                                     | 12                                       | 3,556            | 4,351                            | 466           | 8,373          | 700              | 704                              | 5,638          | 7,042          | 4            | 107,452                         | 16,373         | 2,237                     | 141,493          |
| AQ3                                                     | 836                                      | 4,676            | 2,142                            | 928           | 7,746          | 2,221            | 3,801                            | 11,777         | 17,799         | 536          | 151,836                         | 17,981         | 2,782                     | 199,516          |
| AQ4                                                     | 28                                       | 5,941            | 1,503                            | 874           | 8,318          | 8,696            | 2,111                            | 32,966         | 43,773         | 918          | 55,663                          | 20,303         | 3,204                     | 132,207          |
| AQ5                                                     | —                                        | 1,183            | 403                              | 503           | 2,089          | 2,919            | 657                              | 34,250         | 37,826         | 243          | 11,269                          | 10,469         | 1,184                     | 63,080           |
| AQ6                                                     | —                                        | 282              | 39                               | 252           | 573            | 13               | 50                               | 11,856         | 11,919         | 63           | 1,109                           | 3,359          | 566                       | 17,589           |
| AQ7                                                     | —                                        | —                | —                                | 20            | 20             | 1,089            | 12                               | 9,555          | 10,656         | 173          | 2,278                           | 6,753          | 491                       | 20,371           |
| AQ8                                                     | —                                        | —                | —                                | 8             | 8              | —                | 2                                | 3,023          | 3,025          | —            | 70                              | 1,970          | 63                        | 5,136            |
| AQ9                                                     | —                                        | —                | —                                | 35            | 35             | —                | 7                                | 3,526          | 3,533          | —            | 914                             | 363            | 19                        | 4,864            |
| AQ10                                                    | —                                        | —                | —                                | —             | —              | —                | —                                | 334            | 334            | —            | 302                             | 401            | 46                        | 1,083            |
| Balances<br>with holding<br>company and<br>subsidiaries | —                                        | —                | —                                | 64,911        | 64,911         | —                | —                                | 54,091         | 54,091         | —            | 14,759                          | 5,515          | 2,901                     | 142,177          |
| Past due                                                | —                                        | —                | —                                | —             | —              | —                | 249                              | 1,942          | 2,191          | 170          | —                               | —              | —                         | 2,361            |
| Impaired                                                | —                                        | —                | —                                | 127           | 127            | —                | —                                | 4,313          | 4,313          | —            | —                               | —              | —                         | 4,440            |
| Impairment<br>provision                                 | —                                        | —                | —                                | (108)         | (108)          | —                | —                                | (2,440)        | (2,440)        | —            | —                               | —              | —                         | (2,548)          |
| <b>Total</b>                                            | <b>70,374</b>                            | <b>25,594</b>    | <b>11,545</b>                    | <b>71,613</b> | <b>108,752</b> | <b>42,972</b>    | <b>22,415</b>                    | <b>184,093</b> | <b>249,480</b> | <b>3,086</b> | <b>444,298</b>                  | <b>132,930</b> | <b>18,783</b>             | <b>1,027,703</b> |

For the notes to these tables refer to page 124.

## Financial review *Risk and balance sheet management*

| 2011                                              | Bank                                           |                    |                 |                                                            |                   |                   |                                 |                  |
|---------------------------------------------------|------------------------------------------------|--------------------|-----------------|------------------------------------------------------------|-------------------|-------------------|---------------------------------|------------------|
|                                                   | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                 | Settlement<br>balances and other<br>financial assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m      |
|                                                   |                                                | Banks (1)<br>£m    | Customers<br>£m |                                                            |                   |                   |                                 |                  |
| <b>Core</b>                                       |                                                |                    |                 |                                                            |                   |                   |                                 |                  |
| AQ1                                               | 64,147                                         | 44,917             | 49,951          | 3,221                                                      | 473,118           | 47,511            | 5,469                           | 688,334          |
| AQ2                                               | 9                                              | 1,123              | 6,026           | 41                                                         | 6,564             | 18,508            | 744                             | 33,015           |
| AQ3                                               | 23                                             | 1,521              | 17,670          | 9                                                          | 9,341             | 16,796            | 1,589                           | 46,949           |
| AQ4                                               | 18                                             | 1,163              | 31,544          | 721                                                        | 12,552            | 19,149            | 1,099                           | 66,246           |
| AQ5                                               | 43                                             | 649                | 41,667          | 22                                                         | 3,964             | 11,950            | 943                             | 59,238           |
| AQ6                                               | 8                                              | 106                | 10,748          | 3                                                          | 1,457             | 5,008             | 356                             | 17,686           |
| AQ7                                               | 7                                              | 87                 | 5,187           | 11                                                         | 460               | 7,032             | 165                             | 12,949           |
| AQ8                                               | 1                                              | 9                  | 2,651           | 19                                                         | 477               | 1,171             | 22                              | 4,350            |
| AQ9                                               | 5                                              | 7                  | 3,482           | 3                                                          | 496               | 519               | 29                              | 4,541            |
| AQ10                                              | —                                              | 159                | —               | —                                                          | 227               | 511               | 21                              | 918              |
| Balances with holding company<br>and subsidiaries | —                                              | 58,947             | 142,331         | —                                                          | 18,119            | 9,735             | 5,753                           | 234,885          |
| Past due                                          | —                                              | —                  | 1,349           | —                                                          | —                 | —                 | —                               | 1,349            |
| Impaired                                          | —                                              | 85                 | 3,396           | —                                                          | —                 | —                 | —                               | 3,481            |
| Impairment provision                              | —                                              | (76)               | (1,443)         | —                                                          | —                 | —                 | —                               | (1,519)          |
| Total excluding disposal groups                   | 64,261                                         | 108,697            | 314,559         | 4,050                                                      | 526,775           | 137,890           | 16,190                          | 1,172,422        |
| Disposal groups                                   | 94                                             | —                  | 18,063          | —                                                          | 414               | —                 | —                               | 18,571           |
| <b>Total</b>                                      | <b>64,355</b>                                  | <b>108,697</b>     | <b>332,622</b>  | <b>4,050</b>                                               | <b>527,189</b>    | <b>137,890</b>    | <b>16,190</b>                   | <b>1,190,993</b> |

|                                                         | Bank                                           |                    |                 |                                                            |                   |                   |                                 |               |
|---------------------------------------------------------|------------------------------------------------|--------------------|-----------------|------------------------------------------------------------|-------------------|-------------------|---------------------------------|---------------|
|                                                         | Cash and<br>balances at<br>central banks<br>£m | Loans and advances |                 | Settlement<br>balances and other<br>financial assets<br>£m | Derivatives<br>£m | Commitments<br>£m | Contingent<br>liabilities<br>£m | Total<br>£m   |
|                                                         |                                                | Banks<br>£m        | Customers<br>£m |                                                            |                   |                   |                                 |               |
| <b>Non-Core</b>                                         |                                                |                    |                 |                                                            |                   |                   |                                 |               |
| AQ1                                                     | 9                                              | —                  | 218             | 1                                                          | 227               | 152               | 24                              | 631           |
| AQ2                                                     | —                                              | —                  | 143             | —                                                          | 127               | 43                | 22                              | 335           |
| AQ3                                                     | —                                              | —                  | 213             | —                                                          | 358               | 102               | 18                              | 691           |
| AQ4                                                     | 59                                             | 10                 | 967             | 22                                                         | 444               | 195               | 211                             | 1,908         |
| AQ5                                                     | —                                              | —                  | 988             | —                                                          | 707               | 134               | 84                              | 1,913         |
| AQ6                                                     | —                                              | 3                  | 1,274           | —                                                          | 296               | 240               | 24                              | 1,837         |
| AQ7                                                     | —                                              | 33                 | 450             | —                                                          | 220               | 138               | 4                               | 845           |
| AQ8                                                     | —                                              | —                  | 360             | —                                                          | 36                | 34                | 1                               | 431           |
| AQ9                                                     | —                                              | —                  | 2,632           | —                                                          | 122               | 63                | 1                               | 2,818         |
| AQ10                                                    | —                                              | —                  | 30              | —                                                          | 380               | 119               | 72                              | 601           |
| Balances with<br>holding<br>company<br>and subsidiaries | —                                              | 154                | 1,650           | —                                                          | 160               | —                 | —                               | 1,964         |
| Past due                                                | —                                              | —                  | 22              | 37                                                         | —                 | —                 | —                               | 59            |
| Impaired                                                | —                                              | —                  | 6,446           | —                                                          | —                 | —                 | —                               | 6,446         |
| Impairment<br>provision                                 | —                                              | —                  | (3,371)         | —                                                          | —                 | —                 | —                               | (3,371)       |
| <b>Total</b>                                            | <b>68</b>                                      | <b>200</b>         | <b>12,022</b>   | <b>60</b>                                                  | <b>3,077</b>      | <b>1,220</b>      | <b>461</b>                      | <b>17,108</b> |

For the notes to these tables refer to page 124.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Asset quality continued

| 2012                                                    | Loans and advances |                  |         |         | Bank                                                    |             |             |                           |         |
|---------------------------------------------------------|--------------------|------------------|---------|---------|---------------------------------------------------------|-------------|-------------|---------------------------|---------|
|                                                         | Customers          |                  |         | Total   | Settlement<br>balances and<br>other financial<br>assets | Derivatives | Commitments | Contingent<br>liabilities | Total   |
|                                                         | Banks              | Reverse<br>repos | Other   |         |                                                         |             |             |                           |         |
|                                                         | £m                 | £m               | £m      | £m      | £m                                                      | £m          | £m          | £m                        | £m      |
| Non-Core                                                |                    |                  |         |         |                                                         |             |             |                           |         |
| AQ1                                                     | 22                 | —                | 2,810   | 2,810   | —                                                       | 661         | 597         | 295                       | 4,385   |
| AQ2                                                     | —                  | —                | 904     | 904     | —                                                       | 456         | 23          | 18                        | 1,401   |
| AQ3                                                     | —                  | —                | 425     | 425     | —                                                       | 342         | 162         | 11                        | 940     |
| AQ4                                                     | —                  | —                | 1,584   | 1,584   | —                                                       | 981         | 254         | 81                        | 2,900   |
| AQ5                                                     | —                  | —                | 3,108   | 3,108   | —                                                       | 974         | 575         | 65                        | 4,722   |
| AQ6                                                     | —                  | —                | 1,829   | 1,829   | —                                                       | 691         | 575         | 27                        | 3,122   |
| AQ7                                                     | 37                 | —                | 2,768   | 2,768   | —                                                       | 665         | 1,203       | 5                         | 4,678   |
| AQ8                                                     | —                  | —                | 1,126   | 1,126   | —                                                       | 6           | 57          | —                         | 1,189   |
| AQ9                                                     | —                  | 23               | 1,019   | 1,042   | —                                                       | 248         | 178         | 1                         | 1,469   |
| AQ10                                                    | —                  | —                | 79      | 79      | —                                                       | 322         | 370         | 85                        | 856     |
| Balances<br>with holding<br>company<br>and subsidiaries | 760                | —                | 1,377   | 1,377   | —                                                       | 194         | —           | —                         | 2,331   |
| Past due                                                | —                  | —                | 88      | 88      | 4                                                       | —           | —           | —                         | 92      |
| Impaired                                                | —                  | —                | 8,007   | 8,007   | —                                                       | —           | —           | —                         | 8,007   |
| Impairment<br>provision                                 | —                  | —                | (3,078) | (3,078) | —                                                       | —           | —           | —                         | (3,078) |
| Total                                                   | 819                | 23               | 22,046  | 22,069  | 4                                                       | 5,540       | 3,994       | 588                       | 33,014  |

|                                                   | Bank               |           |                                                      |             |             |                           |         |
|---------------------------------------------------|--------------------|-----------|------------------------------------------------------|-------------|-------------|---------------------------|---------|
|                                                   | Loans and advances |           | Settlement<br>balances and other<br>financial assets | Derivatives | Commitments | Contingent<br>liabilities | Total   |
|                                                   | Banks (1)          | Customers |                                                      |             |             |                           |         |
|                                                   | £m                 | £m        | £m                                                   | £m          | £m          | £m                        | £m      |
| Non-Core                                          |                    |           |                                                      |             |             |                           |         |
| AQ1                                               | 2                  | 8,671     | 6                                                    | 3,600       | 1,749       | 620                       | 14,648  |
| AQ2                                               | —                  | 712       | 2                                                    | 521         | 850         | 3                         | 2,088   |
| AQ3                                               | —                  | 1,046     | —                                                    | 457         | 476         | 42                        | 2,021   |
| AQ4                                               | —                  | 3,493     | 1                                                    | 880         | 844         | 124                       | 5,342   |
| AQ5                                               | —                  | 4,423     | —                                                    | 1,371       | 879         | 165                       | 6,838   |
| AQ6                                               | —                  | 3,741     | —                                                    | 221         | 720         | 1                         | 4,683   |
| AQ7                                               | —                  | 2,237     | —                                                    | 1,593       | 1,395       | 69                        | 5,294   |
| AQ8                                               | —                  | 422       | —                                                    | 388         | 35          | 37                        | 882     |
| AQ9                                               | —                  | 2,417     | —                                                    | 481         | 111         | 9                         | 3,018   |
| AQ10                                              | —                  | 136       | —                                                    | 672         | 582         | 9                         | 1,399   |
| Balances with holding company<br>and subsidiaries | 25                 | 3,426     | —                                                    | 338         | —           | —                         | 3,789   |
| Past due                                          | —                  | 125       | —                                                    | —           | —           | —                         | 125     |
| Impaired                                          | —                  | 8,819     | —                                                    | —           | —           | —                         | 8,819   |
| Impairment provision                              | —                  | (3,104)   | —                                                    | —           | —           | —                         | (3,104) |
| Total excluding disposal groups                   | 27                 | 36,564    | 9                                                    | 10,522      | 7,641       | 1,079                     | 55,842  |
| Disposal groups                                   | 1                  | 47        | —                                                    | —           | —           | —                         | 48      |
| Total including disposal groups                   | 28                 | 36,611    | 9                                                    | 10,522      | 7,641       | 1,079                     | 55,890  |

#### Notes:

(1) Excluding items in the course of collection from other banks of £349 million (2012 - £303 million; 2011 - £316 million).

(2) Exposures are allocated to asset quality bands on the basis of statistically driven models which produce an estimate of default rate. The variables included in the models vary by product and geography. For portfolios secured on residential property these models typically include measures of delinquency and loan-to-value as well as other differentiating characteristics such as bureau score, product features or associated account performance information.

## Financial review *Risk and balance sheet management*

### Debt securities

#### IFRS measurement classification and issuer

The table below analyses debt securities by issuer and IFRS measurement classifications. US central and local government includes US federal agencies; financial institutions includes US government sponsored agencies and securitisation entities, the latter principally relating to asset-backed securities (ABS).

|                             | Central and local government |          |             | Other financial |                    | Corporate | Total    | Of which  |
|-----------------------------|------------------------------|----------|-------------|-----------------|--------------------|-----------|----------|-----------|
|                             | UK<br>£m                     | US<br>£m | Other<br>£m | Banks<br>£m     | institutions<br>£m | £m        | £m       | ABS<br>£m |
| <b>2013</b>                 |                              |          |             |                 |                    |           |          |           |
| Held-for-trading (HFT)      | 6,764                        | 10,945   | 22,557      | 1,608           | 12,407             | 1,977     | 56,258   | 10,674    |
| Designated as at fair value | —                            | —        | —           | —               | 14                 | —         | 14       | 14        |
| Available-for-sale          | 6,436                        | 11,456   | 6,824       | 2,531           | 13,290             | 145       | 40,682   | 16,976    |
| Loans and receivables       | 10                           | 1        | —           | 169             | 3,426              | 136       | 3,742    | 3,423     |
| Long positions              | 13,210                       | 22,402   | 29,381      | 4,308           | 29,137             | 2,258     | 100,696  | 31,087    |
| Of which US agencies        | —                            | 5,599    | —           | —               | 13,132             | —         | 18,731   | 18,048    |
| Short positions (HFT)       | (1,784)                      | (6,790)  | (16,087)    | (888)           | (1,373)            | (826)     | (27,748) | (36)      |
| <i>Available-for-sale</i>   |                              |          |             |                 |                    |           |          |           |
| Gross unrealised gains      | 201                          | 272      | 106         | 2               | 333                | 9         | 923      | 361       |
| Gross unrealised losses     | (69)                         | (86)     | (25)        | (1)             | (196)              | (1)       | (378)    | (252)     |
| <b>2012</b>                 |                              |          |             |                 |                    |           |          |           |
| Held-for-trading            | 7,692                        | 17,303   | 26,344      | 2,036           | 21,722             | 1,933     | 77,030   | 18,619    |
| Designated as at fair value | —                            | —        | —           | 86              | 610                | 1         | 697      | 516       |
| Available-for-sale          | 7,950                        | 17,514   | 10,083      | 2,933           | 15,967             | 114       | 54,561   | 18,953    |
| Loans and receivables       | 5                            | —        | —           | 327             | 3,683              | 282       | 4,297    | 3,663     |
| Long positions              | 15,647                       | 34,817   | 36,427      | 5,382           | 41,982             | 2,330     | 136,585  | 41,751    |
| Of which US agencies        | —                            | 5,380    | —           | —               | 21,566             | —         | 26,946   | 24,847    |
| Short positions (HFT)       | (1,538)                      | (10,658) | (11,333)    | (1,035)         | (1,578)            | (798)     | (26,940) | (17)      |
| <i>Available-for-sale</i>   |                              |          |             |                 |                    |           |          |           |
| Gross unrealised gains      | 944                          | 861      | 579         | 17              | 582                | 8         | 2,991    | 647       |
| Gross unrealised losses     | —                            | (1)      | —           | (1)             | (122)              | —         | (124)    | (124)     |
| <b>2011</b>                 |                              |          |             |                 |                    |           |          |           |
| Held-for-trading            | 9,004                        | 18,770   | 35,146      | 3,649           | 22,577             | 2,615     | 91,761   | 20,815    |
| Designated as at fair value | 1                            | —        | —           | 53              | 457                | 9         | 520      | 418       |
| Available-for-sale          | 10,654                       | 18,769   | 13,987      | 4,624           | 22,907             | 451       | 71,392   | 25,996    |
| Loans and receivables       | 10                           | —        | —           | 32              | 5,093              | 333       | 5,468    | 5,057     |
| Long positions              | 19,669                       | 37,539   | 49,133      | 8,358           | 51,034             | 3,408     | 169,141  | 52,286    |
| Of which US agencies        | —                            | 4,896    | —           | —               | 25,924             | —         | 30,820   | 28,558    |
| Short positions (HFT)       | (3,098)                      | (10,661) | (19,053)    | (2,479)         | (2,739)            | (754)     | (38,784) | (352)     |
| <i>Available-for-sale</i>   |                              |          |             |                 |                    |           |          |           |
| Gross unrealised gains      | 1,312                        | 967      | 700         | 3               | 874                | 9         | 3,865    | 952       |
| Gross unrealised losses     | —                            | —        | —           | (32)            | (326)              | (12)      | (370)    | (336)     |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Debt securities continued

##### Ratings

The table below analyses debt securities by issuer and external ratings. Ratings are based on the lower of Standard and Poor's, Moody's and Fitch.

|                                                   | Group                        |        |        |                 |              |           |         |           |                 |
|---------------------------------------------------|------------------------------|--------|--------|-----------------|--------------|-----------|---------|-----------|-----------------|
|                                                   | Central and local government |        |        | Other financial |              | Corporate | Total   | Total (1) | Of which<br>ABS |
|                                                   | UK                           | US     | Other  | Banks           | institutions |           |         |           |                 |
| 2013                                              | £m                           | £m     | £m     | £m              | £m           | £m        | £m      | %         | £m              |
| Total                                             |                              |        |        |                 |              |           |         |           |                 |
| AAA                                               | —                            | 18     | 13,026 | 1,327           | 7,245        | 149       | 21,765  | 22        | 5,783           |
| AA to AA+                                         | 13,210                       | 22,382 | 6,600  | 300             | 15,311       | 110       | 57,913  | 58        | 19,431          |
| A to AA-                                          | —                            | —      | 3,339  | 1,564           | 1,256        | 282       | 6,441   | 6         | 1,160           |
| BBB- to A-                                        | —                            | —      | 6,113  | 820             | 1,501        | 855       | 9,289   | 9         | 1,044           |
| Non-investment grade                              | —                            | —      | 297    | 165             | 2,212        | 427       | 3,101   | 3         | 2,215           |
| Unrated                                           | —                            | 2      | 6      | 72              | 1,610        | 396       | 2,086   | 2         | 1,454           |
|                                                   | 13,210                       | 22,402 | 29,381 | 4,248           | 29,135       | 2,219     | 100,595 | 100       | 31,087          |
| Issued by holding company and fellow subsidiaries |                              |        |        |                 |              |           |         |           |                 |
|                                                   | —                            | —      | —      | 60              | 2            | 39        | 101     |           | —               |
|                                                   | 13,210                       | 22,402 | 29,381 | 4,308           | 29,137       | 2,258     | 100,696 |           | 31,087          |
| Core                                              |                              |        |        |                 |              |           |         |           |                 |
| AAA                                               | —                            | 18     | 13,026 | 1,327           | 6,811        | 149       | 21,331  | 22        | 5,378           |
| AA to AA+                                         | 13,210                       | 22,382 | 6,600  | 300             | 15,004       | 110       | 57,606  | 58        | 19,124          |
| A to AA-                                          | —                            | —      | 3,339  | 1,564           | 866          | 282       | 6,051   | 6         | 770             |
| BBB- to A-                                        | —                            | —      | 6,113  | 820             | 1,436        | 855       | 9,224   | 9         | 979             |
| Non-investment grade                              | —                            | —      | 209    | 165             | 1,805        | 340       | 2,519   | 3         | 1,721           |
| Unrated                                           | —                            | 2      | 6      | 72              | 1,403        | 372       | 1,855   | 2         | 1,245           |
|                                                   | 13,210                       | 22,402 | 29,293 | 4,248           | 27,325       | 2,108     | 98,586  | 100       | 29,217          |
| Non-Core                                          |                              |        |        |                 |              |           |         |           |                 |
| AAA                                               | —                            | —      | —      | —               | 434          | —         | 434     | 22        | 405             |
| AA to AA+                                         | —                            | —      | —      | —               | 307          | —         | 307     | 15        | 307             |
| A to AA-                                          | —                            | —      | —      | —               | 390          | —         | 390     | 19        | 390             |
| BBB- to A-                                        | —                            | —      | —      | —               | 65           | —         | 65      | 3         | 65              |
| Non-investment grade                              | —                            | —      | 88     | —               | 407          | 87        | 582     | 29        | 494             |
| Unrated                                           | —                            | —      | —      | —               | 207          | 24        | 231     | 12        | 209             |
|                                                   | —                            | —      | 88     | —               | 1,810        | 111       | 2,009   | 100       | 1,870           |

For the note to these tables refer to page 129.

## Financial review *Risk and balance sheet management*

| 2012                                              | Group                        |          |             |                 |                    |                 |         |           |           |
|---------------------------------------------------|------------------------------|----------|-------------|-----------------|--------------------|-----------------|---------|-----------|-----------|
|                                                   | Central and local government |          |             | Other financial |                    |                 | Total   | Total (1) | Of which  |
|                                                   | UK<br>£m                     | US<br>£m | Other<br>£m | Banks<br>£m     | institutions<br>£m | Corporate<br>£m |         |           | ABS<br>£m |
| <i>Total</i>                                      |                              |          |             |                 |                    |                 |         |           |           |
| AAA                                               | 15,647                       | 31       | 15,988      | 1,645           | 7,843              | 17              | 41,171  | 30        | 7,390     |
| AA to AA+                                         | —                            | 34,785   | 5,951       | 344             | 25,054             | 234             | 66,368  | 49        | 27,059    |
| A to AA-                                          | —                            | —        | 9,997       | 2,103           | 2,792              | 153             | 15,045  | 11        | 2,242     |
| BBB- to A-                                        | —                            | —        | 4,046       | 882             | 1,677              | 1,002           | 7,607   | 6         | 1,582     |
| Non-investment grade                              | —                            | —        | 443         | 95              | 3,077              | 603             | 4,218   | 3         | 2,391     |
| Unrated                                           | —                            | 1        | 2           | 134             | 1,539              | 321             | 1,997   | 1         | 1,087     |
|                                                   | 15,647                       | 34,817   | 36,427      | 5,203           | 41,982             | 2,330           | 136,406 | 100       | 41,751    |
| Issued by holding company and fellow subsidiaries | —                            | —        | —           | 179             | —                  | —               | 179     |           | —         |
|                                                   | 15,647                       | 34,817   | 36,427      | 5,382           | 41,982             | 2,330           | 136,585 |           | 41,751    |
| <i>Core</i>                                       |                              |          |             |                 |                    |                 |         |           |           |
| AAA                                               | 15,647                       | 31       | 15,988      | 1,645           | 6,403              | 17              | 39,731  | 30        | 5,951     |
| AA to AA+                                         | —                            | 34,711   | 5,951       | 344             | 23,531             | 234             | 64,771  | 50        | 25,539    |
| A to AA-                                          | —                            | —        | 9,997       | 2,103           | 1,473              | 153             | 13,726  | 11        | 948       |
| BBB- to A-                                        | —                            | —        | 4,046       | 882             | 1,163              | 963             | 7,054   | 5         | 1,000     |
| Non-investment grade                              | —                            | —        | 435         | 95              | 2,335              | 485             | 3,350   | 3         | 1,893     |
| Unrated                                           | —                            | 1        | 2           | 134             | 1,296              | 299             | 1,732   | 1         | 859       |
|                                                   | 15,647                       | 34,743   | 36,419      | 5,203           | 36,201             | 2,151           | 130,364 | 100       | 36,190    |
| <i>Non-Core</i>                                   |                              |          |             |                 |                    |                 |         |           |           |
| AAA                                               | —                            | —        | —           | —               | 1,440              | —               | 1,440   | 24        | 1,439     |
| AA to AA+                                         | —                            | 74       | —           | —               | 1,523              | —               | 1,597   | 27        | 1,520     |
| A to AA-                                          | —                            | —        | —           | —               | 1,319              | —               | 1,319   | 22        | 1,294     |
| BBB- to A-                                        | —                            | —        | —           | —               | 514                | 39              | 553     | 9         | 582       |
| Non-investment grade                              | —                            | —        | 8           | —               | 742                | 118             | 868     | 14        | 498       |
| Unrated                                           | —                            | —        | —           | —               | 243                | 22              | 265     | 4         | 228       |
|                                                   | —                            | 74       | 8           | —               | 5,781              | 179             | 6,042   | 100       | 5,561     |

For the note to these tables refer to page 129.



## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Debt securities continued

| 2011                                              | Group                        |        |        |                 |              |           |         |           |          |
|---------------------------------------------------|------------------------------|--------|--------|-----------------|--------------|-----------|---------|-----------|----------|
|                                                   | Central and local government |        |        | Other financial |              | Corporate | Total   | Total (1) | Of which |
|                                                   | UK                           | US     | Other  | Banks           | institutions |           |         |           |          |
|                                                   | £m                           | £m     | £m     | £m              | £m           | £m        | £m      | %         | ABS      |
| <i>Total</i>                                      |                              |        |        |                 |              |           |         |           |          |
| AAA                                               | 19,669                       | 45     | 27,638 | 2,221           | 9,828        | 165       | 59,566  | 35        | 9,549    |
| AA to AA+                                         | —                            | 37,490 | 375    | 1,060           | 29,011       | 319       | 68,255  | 41        | 31,560   |
| A to AA-                                          | —                            | 1      | 20,803 | 3,822           | 3,599        | 419       | 28,644  | 17        | 3,113    |
| BBB- to A-                                        | —                            | —      | 66     | 337             | 2,490        | 1,127     | 4,020   | 2         | 2,467    |
| Non-investment grade                              | —                            | —      | 251    | 157             | 4,671        | 1,104     | 6,183   | 4         | 4,362    |
| Unrated                                           | —                            | 3      | —      | 47              | 1,347        | 274       | 1,671   | 1         | 1,235    |
|                                                   | 19,669                       | 37,539 | 49,133 | 7,644           | 50,946       | 3,408     | 168,339 | 100       | 52,286   |
| Issued by holding company and fellow subsidiaries | —                            | —      | —      | 714             | 88           | —         | 802     |           | —        |
|                                                   | 19,669                       | 37,539 | 49,133 | 8,358           | 51,034       | 3,408     | 169,141 |           | 52,286   |
| <i>Core</i>                                       |                              |        |        |                 |              |           |         |           |          |
| AAA                                               | 19,669                       | 45     | 27,638 | 1,799           | 7,246        | 165       | 56,562  | 36        | 6,967    |
| AA to AA+                                         | —                            | 37,490 | 375    | 1,060           | 26,734       | 286       | 65,945  | 42        | 29,283   |
| A to AA-                                          | —                            | 1      | 20,803 | 3,815           | 1,993        | 419       | 27,031  | 17        | 1,522    |
| BBB- to A-                                        | —                            | —      | 66     | 337             | 1,301        | 926       | 2,630   | 2         | 1,174    |
| Non-investment grade                              | —                            | —      | 251    | 157             | 2,504        | 953       | 3,865   | 2         | 2,422    |
| Unrated                                           | —                            | 3      | —      | 45              | 798          | 241       | 1,087   | 1         | 784      |
|                                                   | 19,669                       | 37,539 | 49,133 | 7,213           | 40,576       | 2,990     | 157,120 | 100       | 42,152   |
| <i>Non-Core</i>                                   |                              |        |        |                 |              |           |         |           |          |
| AAA                                               | —                            | —      | —      | 422             | 2,582        | —         | 3,004   | 27        | 2,582    |
| AA to AA+                                         | —                            | —      | —      | —               | 2,277        | 33        | 2,310   | 21        | 2,277    |
| A to AA-                                          | —                            | —      | —      | 7               | 1,606        | —         | 1,613   | 14        | 1,591    |
| BBB- to A-                                        | —                            | —      | —      | —               | 1,189        | 201       | 1,390   | 12        | 1,293    |
| Non-investment grade                              | —                            | —      | —      | —               | 2,167        | 151       | 2,318   | 21        | 1,940    |
| Unrated                                           | —                            | —      | —      | 2               | 549          | 33        | 584     | 5         | 451      |
|                                                   | —                            | —      | —      | 431             | 10,370       | 418       | 11,219  | 100       | 10,134   |

For the note to these tables refer to page 129.

## Financial review *Risk and balance sheet management*

|                                            | Central and local government |        |        | Bank  |                              |           | Total   | Total (1) | Of which |
|--------------------------------------------|------------------------------|--------|--------|-------|------------------------------|-----------|---------|-----------|----------|
|                                            | UK                           | US     | Other  | Banks | Other financial institutions | Corporate |         |           |          |
| 2013                                       | £m                           | £m     | £m     | £m    | £m                           | £m        | £m      | %         | ABS      |
| <i>Total</i>                               |                              |        |        |       |                              |           |         |           | £m       |
| AAA                                        | —                            | 12     | 12,822 | 1,153 | 6,039                        | 139       | 20,165  | 31        | 4,656    |
| AA to AA+                                  | 13,206                       | 7,938  | 6,590  | 279   | 1,926                        | 101       | 30,040  | 46        | 1,227    |
| A to AA-                                   | —                            | —      | 1,056  | 1,510 | 781                          | 158       | 3,505   | 5         | 768      |
| BBB- to A-                                 | —                            | —      | 5,950  | 484   | 1,264                        | 256       | 7,954   | 12        | 881      |
| Non-investment grade                       | —                            | —      | 297    | 161   | 1,170                        | 294       | 1,922   | 3         | 1,183    |
| Unrated                                    | —                            | 2      | 6      | 68    | 1,519                        | 303       | 1,898   | 3         | 1,372    |
|                                            | 13,206                       | 7,952  | 26,721 | 3,655 | 12,699                       | 1,251     | 65,484  | 100       | 10,087   |
| Issued by holding company and subsidiaries | —                            | —      | —      | 9     | 26,795                       | 39        | 26,843  |           | 26,137   |
|                                            | 13,206                       | 7,952  | 26,721 | 3,664 | 39,494                       | 1,290     | 92,327  |           | 36,224   |
| <i>2012</i>                                |                              |        |        |       |                              |           |         |           |          |
| AAA                                        | 15,642                       | 24     | 15,690 | 1,501 | 7,100                        | 12        | 39,969  | 45        | 6,586    |
| AA to AA+                                  | —                            | 18,138 | 5,950  | 344   | 3,203                        | 213       | 27,848  | 31        | 2,029    |
| A to AA-                                   | —                            | —      | 7,091  | 2,012 | 1,658                        | 68        | 10,829  | 12        | 1,317    |
| BBB- to A-                                 | —                            | —      | 3,767  | 644   | 1,380                        | 451       | 6,242   | 7         | 1,335    |
| Non-investment grade                       | —                            | —      | 435    | 90    | 1,777                        | 395       | 2,697   | 3         | 1,123    |
| Unrated                                    | —                            | 1      | 2      | 119   | 1,225                        | 218       | 1,565   | 2         | 805      |
|                                            | 15,642                       | 18,163 | 32,935 | 4,710 | 16,343                       | 1,357     | 89,150  | 100       | 13,195   |
| Issued by holding company and subsidiaries | —                            | —      | —      | 147   | 33,150                       | —         | 33,297  |           | 32,486   |
|                                            | 15,642                       | 18,163 | 32,935 | 4,857 | 49,493                       | 1,357     | 122,447 |           | 45,681   |
| <i>2011</i>                                |                              |        |        |       |                              |           |         |           |          |
| AAA                                        | 19,664                       | —      | 27,238 | 1,521 | 8,500                        | 160       | 57,083  | 51        | 8,167    |
| AA to AA+                                  | —                            | 18,317 | 367    | 1,030 | 3,067                        | 193       | 22,974  | 21        | 3,147    |
| A to AA-                                   | —                            | —      | 16,992 | 3,542 | 3,028                        | 289       | 23,851  | 21        | 2,523    |
| BBB- to A-                                 | —                            | —      | 61     | 112   | 1,863                        | 738       | 2,774   | 3         | 1,850    |
| Non-investment grade                       | —                            | —      | 249    | 140   | 2,435                        | 799       | 3,623   | 3         | 2,465    |
| Unrated                                    | —                            | —      | —      | 11    | 855                          | 142       | 1,008   | 1         | 535      |
|                                            | 19,664                       | 18,317 | 44,907 | 6,356 | 19,748                       | 2,321     | 111,313 | 100       | 18,687   |
| Issued by holding company and subsidiaries | —                            | —      | —      | 953   | 69,194                       | —         | 70,147  |           | 68,785   |
|                                            | 19,664                       | 18,317 | 44,907 | 7,309 | 88,942                       | 2,321     | 181,460 |           | 87,472   |

Note:  
(1) Percentage calculated before balances with Group companies.

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## Financial review *Risk and balance sheet management*

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### Balance sheet analysis continued

#### Debt securities continued

##### Asset-backed securities

###### Introduction

The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets. The carrying value of the Group's debt securities is detailed below.

The Group's credit market activities gave rise to risk concentrations in asset-backed securities (ABS). The Group has exposures to ABS, which are predominantly debt securities, but can also be held in derivative form. ABS have an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed onto investors by the issue of securities with varying seniority by a special purpose entity.

Debt securities include residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and other ABS. In many cases, the risk associated with these assets is hedged by credit derivatives. The counterparties to some of these hedge transactions are monoline insurers.

The following tables summarise the gross and net exposures and carrying values of these securities by the location of the underlying assets at 31 December 2013, 2012 and 2011 and by IFRS measurement classification of held-for-trading (HFT), designated at fair value (DFV), available-for-sale (AFS) and loans and receivables (LAR). Gross exposures represent the principal amounts relating to ABS. Government sponsored or similar RMBS comprises securities that are: (a) guaranteed or effectively guaranteed by the US government, by way of its support for US federal agencies and government sponsored enterprises or (b) guaranteed by the Dutch government. Net exposures represent the carrying value after taking account of protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

##### Residential mortgage-backed securities

RMBS are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The risk of the RMBS will vary primarily depending on the quality and geographic region in which the underlying mortgage assets are located and the credit enhancement of the securitisation structure. Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes.

The main categories of mortgages that serve as collateral to RMBS held by the Group are set out below and described in the Glossary on pages 347 to 353. The US market has more established definitions of differing underlying mortgage quality and these are used as the basis for the Group's RMBS categorisation.

The Group RMBS classifications, including prime, non-conforming and sub-prime, reflect the characteristics of the underlying mortgage portfolios. RMBS are classified as prime RMBS where the loans have low default risk and are made to borrowers with good credit records and reliable payment histories and there is full documentation. Non-conforming RMBS include US Alt-A RMBS together with RMBS, in jurisdictions other than the US, where the underlying mortgages are not classified as either prime or sub-prime. Classification of RMBS as sub-prime or Alt-A is based on Fair Isaac Corporation scores (FICO), level of documentation and loan-to-value ratios of the underlying mortgage loans. US RMBS are classified as sub-prime if the mortgage portfolio comprises loans with FICO scores between 500 and 650 with full or limited documentation. Mortgages in Alt-A RMBS portfolios have FICO scores of 640 to 720, limited documentation and an original LTV of 70% to 100%. In other jurisdictions, RMBS are classified as sub-prime if the mortgage portfolio comprises loans with one or more high risk characteristics such as: unreliable or poor payment histories; high loan-to-value ratios; high debt-to-income ratio; the loan is not secured on the borrower's primary residence; or a history of delinquencies or late payments on the loan.

## Financial review *Risk and balance sheet management*

### Product, geography and IFRS measurement classification

| 2013                                  | US<br>£m | UK<br>£m | Europe<br>£m | RoW<br>£m | Total<br>£m | HFT<br>£m | DFV<br>£m | AFS<br>£m | LAR<br>£m |
|---------------------------------------|----------|----------|--------------|-----------|-------------|-----------|-----------|-----------|-----------|
| <b>Gross exposure</b>                 |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 14,886   | —        | —            | —         | 14,886      | 7,088     | —         | 7,798     | —         |
| RMBS: prime                           | 1,607    | 1,694    | 806          | 99        | 4,206       | 777       | 14        | 3,392     | 23        |
| RMBS: non-conforming                  | 446      | 1,859    | 49           | —         | 2,354       | 165       | —         | 960       | 1,229     |
| RMBS: sub-prime                       | 818      | 86       | 59           | —         | 963         | 871       | —         | —         | 92        |
| CMBS                                  | 3,598    | 689      | 254          | 1         | 4,542       | 858       | —         | 3,124     | 560       |
| CDOs                                  | 1,835    | 32       | 277          | —         | 2,144       | 1,602     | 21        | 511       | 10        |
| CLOs                                  | 907      | 36       | 568          | —         | 1,511       | 898       | —         | 583       | 30        |
| ABS                                   | 1,432    | 1,428    | 937          | 40        | 3,837       | 1,266     | —         | 1,053     | 1,518     |
|                                       | 25,529   | 5,824    | 2,950        | 140       | 34,443      | 13,525    | 35        | 17,421    | 3,462     |
| <b>Carrying value</b>                 |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 14,870   | —        | —            | —         | 14,870      | 7,031     | —         | 7,839     | —         |
| RMBS: prime                           | 1,532    | 1,696    | 775          | 99        | 4,102       | 713       | 14        | 3,352     | 23        |
| RMBS: non-conforming                  | 379      | 1,770    | 49           | —         | 2,198       | 128       | —         | 841       | 1,229     |
| RMBS: sub-prime                       | 775      | 78       | 45           | —         | 898         | 806       | —         | —         | 92        |
| CMBS                                  | 3,523    | 558      | 127          | 1         | 4,209       | 602       | —         | 3,077     | 530       |
| CDOs                                  | 314      | 1        | 115          | —         | 430         | 98        | —         | 322       | 10        |
| CLOs                                  | 823      | 15       | 300          | —         | 1,138       | 552       | —         | 558       | 28        |
| ABS                                   | 1,349    | 943      | 911          | 39        | 3,242       | 744       | —         | 987       | 1,511     |
|                                       | 23,565   | 5,061    | 2,322        | 139       | 31,087      | 10,674    | 14        | 16,976    | 3,423     |
| <b>Net exposure</b>                   |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 14,869   | —        | —            | —         | 14,869      | 7,031     | —         | 7,838     | —         |
| RMBS: prime                           | 1,527    | 1,694    | 771          | 99        | 4,091       | 702       | 14        | 3,352     | 23        |
| RMBS: non-conforming                  | 348      | 1,761    | 49           | —         | 2,158       | 90        | —         | 839       | 1,229     |
| RMBS: sub-prime                       | 569      | 78       | 45           | —         | 692         | 600       | —         | —         | 92        |
| CMBS                                  | 3,247    | 558      | 127          | 1         | 3,933       | 325       | —         | 3,076     | 532       |
| CDOs                                  | 36       | 1        | 115          | —         | 152         | 90        | —         | 52        | 10        |
| CLOs                                  | 473      | 15       | 296          | —         | 784         | 493       | —         | 263       | 28        |
| ABS                                   | 1,252    | 922      | 911          | 39        | 3,124       | 628       | —         | 986       | 1,510     |
|                                       | 22,321   | 5,029    | 2,314        | 139       | 29,803      | 9,959     | 14        | 16,406    | 3,424     |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Debt securities continued

| 2012                                  | US<br>£m      | UK<br>£m     | Europe<br>£m | RoW<br>£m  | Total<br>£m   | HFT<br>£m     | DFV<br>£m  | AFS<br>£m     | LAR<br>£m    |
|---------------------------------------|---------------|--------------|--------------|------------|---------------|---------------|------------|---------------|--------------|
| <b>Gross exposure</b>                 |               |              |              |            |               |               |            |               |              |
| RMBS: government sponsored or similar | 22,162        | —            | —            | 18         | 22,180        | 13,961        | —          | 8,219         | —            |
| RMBS: prime                           | 819           | 2,818        | 1,161        | 403        | 5,201         | 753           | 509        | 3,871         | 68           |
| RMBS: non-conforming                  | 595           | 2,077        | 58           | —          | 2,730         | 202           | —          | 1,235         | 1,293        |
| RMBS: sub-prime                       | 968           | 99           | 66           | 5          | 1,138         | 1,027         | —          | 5             | 106          |
| CMBS                                  | 3,352         | 1,113        | 656          | 3          | 5,124         | 1,992         | —          | 2,327         | 805          |
| CDOs                                  | 4,002         | 42           | 274          | —          | 4,318         | 3,111         | —          | 1,177         | 30           |
| CLOs                                  | 2,705         | 44           | 702          | —          | 3,451         | 1,049         | —          | 2,336         | 66           |
| ABS                                   | 1,589         | 1,572        | 1,004        | 306        | 4,471         | 1,667         | 7          | 1,330         | 1,467        |
|                                       | <b>36,192</b> | <b>7,765</b> | <b>3,921</b> | <b>735</b> | <b>48,613</b> | <b>23,762</b> | <b>516</b> | <b>20,500</b> | <b>3,835</b> |
| <b>Carrying value</b>                 |               |              |              |            |               |               |            |               |              |
| RMBS: government sponsored or similar | 22,460        | —            | —            | 18         | 22,478        | 13,959        | —          | 8,519         | —            |
| RMBS: prime                           | 717           | 2,549        | 896          | 389        | 4,551         | 569           | 509        | 3,416         | 57           |
| RMBS: non-conforming                  | 477           | 1,918        | 58           | —          | 2,453         | 150           | —          | 1,010         | 1,293        |
| RMBS: sub-prime                       | 660           | 73           | 46           | 4          | 783           | 682           | —          | —             | 101          |
| CMBS                                  | 3,274         | 814          | 410          | 3          | 4,501         | 1,489         | —          | 2,284         | 728          |
| CDOs                                  | 480           | 22           | 97           | —          | 599           | 104           | —          | 467           | 28           |
| CLOs                                  | 2,550         | 12           | 391          | —          | 2,953         | 697           | —          | 2,193         | 63           |
| ABS                                   | 1,357         | 954          | 827          | 295        | 3,433         | 969           | 7          | 1,064         | 1,393        |
|                                       | <b>31,975</b> | <b>6,342</b> | <b>2,725</b> | <b>709</b> | <b>41,751</b> | <b>18,619</b> | <b>516</b> | <b>18,953</b> | <b>3,663</b> |
| <b>Net exposure</b>                   |               |              |              |            |               |               |            |               |              |
| RMBS: government sponsored or similar | 22,460        | —            | —            | 18         | 22,478        | 13,959        | —          | 8,519         | —            |
| RMBS: prime                           | 513           | 2,546        | 894          | 383        | 4,336         | 554           | 509        | 3,216         | 57           |
| RMBS: non-conforming                  | 277           | 1,908        | 58           | —          | 2,243         | 110           | —          | 840           | 1,293        |
| RMBS: sub-prime                       | 417           | 73           | 46           | 4          | 540           | 439           | —          | —             | 101          |
| CMBS                                  | 2,535         | 814          | 410          | 3          | 3,762         | 750           | —          | 2,284         | 728          |
| CDOs                                  | 162           | 22           | 91           | —          | 275           | 79            | —          | 168           | 28           |
| CLOs                                  | 879           | 12           | 386          | —          | 1,277         | 639           | —          | 575           | 63           |
| ABS                                   | 1,214         | 860          | 827          | 163        | 3,064         | 601           | 7          | 1,064         | 1,392        |
|                                       | <b>28,457</b> | <b>6,235</b> | <b>2,712</b> | <b>571</b> | <b>37,975</b> | <b>17,131</b> | <b>516</b> | <b>16,666</b> | <b>3,662</b> |

## Financial review *Risk and balance sheet management*

| 2011                                  | US<br>£m | UK<br>£m | Europe<br>£m | RoW<br>£m | Total<br>£m | HFT<br>£m | DFV<br>£m | AFS<br>£m | LAR<br>£m |
|---------------------------------------|----------|----------|--------------|-----------|-------------|-----------|-----------|-----------|-----------|
| Gross exposure                        |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 27,549   | —        | —            | 2         | 27,551      | 15,032    | —         | 12,519    | —         |
| RMBS: prime                           | 1,201    | 3,251    | 1,520        | 484       | 6,456       | 1,090     | 428       | 4,929     | 9         |
| RMBS: non-conforming                  | 1,220    | 2,197    | 74           | —         | 3,491       | 717       | —         | 1,402     | 1,372     |
| RMBS: sub-prime                       | 1,847    | 424      | 94           | 2         | 2,367       | 2,183     | —         | 22        | 162       |
| CMBS                                  | 1,623    | 1,551    | 841          | 1         | 4,016       | 2,001     | —         | 862       | 1,153     |
| CDOs                                  | 7,889    | 72       | 315          | —         | 8,276       | 4,454     | —         | 3,732     | 90        |
| CLOs                                  | 5,019    | 156      | 740          | —         | 5,915       | 1,294     | —         | 4,420     | 201       |
| ABS                                   | 2,085    | 1,792    | 1,627        | 971       | 6,475       | 1,966     | 17        | 2,211     | 2,281     |
|                                       | 48,433   | 9,443    | 5,211        | 1,460     | 64,547      | 28,737    | 445       | 30,097    | 5,268     |
| Carrying value                        |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 28,022   | —        | —            | 2         | 28,024      | 15,132    | —         | 12,892    | —         |
| RMBS: prime                           | 1,035    | 2,802    | 1,186        | 466       | 5,489       | 870       | 418       | 4,199     | 2         |
| RMBS: non-conforming                  | 708      | 1,897    | 74           | —         | 2,679       | 326       | —         | 981       | 1,372     |
| RMBS: sub-prime                       | 686      | 141      | 72           | 2         | 901         | 737       | —         | 9         | 155       |
| CMBS                                  | 1,502    | 1,241    | 592          | 1         | 3,336       | 1,511     | —         | 717       | 1,108     |
| CDOs                                  | 1,632    | 31       | 156          | —         | 1,819       | 315       | —         | 1,417     | 87        |
| CLOs                                  | 4,524    | 98       | 443          | —         | 5,065       | 884       | —         | 4,004     | 177       |
| ABS                                   | 1,715    | 894      | 1,420        | 944       | 4,973       | 1,040     | —         | 1,777     | 2,156     |
|                                       | 39,824   | 7,104    | 3,943        | 1,415     | 52,286      | 20,815    | 418       | 25,996    | 5,057     |
| Net exposure                          |          |          |              |           |             |           |           |           |           |
| RMBS: government sponsored or similar | 28,022   | —        | —            | 2         | 28,024      | 15,132    | —         | 12,892    | —         |
| RMBS: prime                           | 825      | 3,223    | 985          | 458       | 5,491       | 447       | 418       | 4,624     | 2         |
| RMBS: non-conforming                  | 677      | 2,225    | 74           | —         | 2,976       | 284       | —         | 1,320     | 1,372     |
| RMBS: sub-prime                       | 385      | 135      | 67           | 2         | 589         | 434       | —         | —         | 155       |
| CMBS                                  | 860      | 1,241    | 500          | 1         | 2,602       | 777       | —         | 717       | 1,108     |
| CDOs                                  | 1,030    | 31       | 156          | —         | 1,217       | 304       | —         | 826       | 87        |
| CLOs                                  | 1,367    | 98       | 436          | —         | 1,901       | 827       | —         | 896       | 178       |
| ABS                                   | 1,456    | 789      | 1,420        | 782       | 4,447       | 617       | —         | 1,774     | 2,056     |
|                                       | 34,622   | 7,742    | 3,638        | 1,245     | 47,247      | 18,822    | 418       | 23,049    | 4,958     |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Debt securities continued

##### Ratings

The table below summarises the rating levels of ABS carrying values.

|                          | RMBS                                            |             |                          |                 | CMBS<br>£m | CDOs<br>£m | CLOs<br>£m | Other<br>ABS<br>£m | Total<br>£m |
|--------------------------|-------------------------------------------------|-------------|--------------------------|-----------------|------------|------------|------------|--------------------|-------------|
|                          | Government<br>sponsored<br>or similar (1)<br>£m | Prime<br>£m | Non-<br>conforming<br>£m | Sub-prime<br>£m |            |            |            |                    |             |
| 2013                     |                                                 |             |                          |                 |            |            |            |                    |             |
| AAA                      | 3                                               | 2,974       | 790                      | 24              | 165        | 66         | 313        | 1,448              | 5,783       |
| AA to AA+                | 14,867                                          | 192         | 634                      | 28              | 3,224      | —          | 308        | 178                | 19,431      |
| A to AA-                 | —                                               | 151         | 227                      | 34              | 60         | 60         | 167        | 461                | 1,160       |
| BBB- to A-               | —                                               | 126         | 162                      | 95              | 102        | 25         | 88         | 446                | 1,044       |
| Non-investment grade (2) | —                                               | 559         | 369                      | 492             | 160        | 258        | 144        | 233                | 2,215       |
| Unrated (2)              | —                                               | 100         | 16                       | 225             | 498        | 21         | 118        | 476                | 1,454       |
|                          | 14,870                                          | 4,102       | 2,198                    | 898             | 4,209      | 430        | 1,138      | 3,242              | 31,087      |
| 2012                     |                                                 |             |                          |                 |            |            |            |                    |             |
| AAA                      | 18                                              | 2,853       | 1,487                    | 11              | 396        | 92         | 1,181      | 1,352              | 7,390       |
| AA to AA+                | 22,460                                          | 613         | 88                       | 26              | 2,541      | 7          | 887        | 437                | 27,059      |
| A to AA-                 | —                                               | 299         | 275                      | 33              | 799        | 74         | 146        | 616                | 2,242       |
| BBB- to A-               | —                                               | 41          | 141                      | 86              | 441        | 32         | 217        | 624                | 1,582       |
| Non-investment grade (2) | —                                               | 638         | 454                      | 330             | 301        | 299        | 133        | 236                | 2,391       |
| Unrated (2)              | —                                               | 107         | 8                        | 297             | 23         | 95         | 389        | 168                | 1,087       |
|                          | 22,478                                          | 4,551       | 2,453                    | 783             | 4,501      | 599        | 2,953      | 3,433              | 41,751      |
| 2011                     |                                                 |             |                          |                 |            |            |            |                    |             |
| AAA                      | 5                                               | 3,431       | 1,488                    | 105             | 647        | 135        | 2,106      | 1,632              | 9,549       |
| AA to AA+                | 28,019                                          | 605         | 106                      | 57              | 695        | 35         | 1,503      | 540                | 31,560      |
| A to AA-                 | —                                               | 499         | 110                      | 104             | 1,195      | 142        | 516        | 547                | 3,113       |
| BBB- to A-               | —                                               | 22          | 288                      | 93              | 333        | 71         | 341        | 1,319              | 2,467       |
| Non-investment grade (2) | —                                               | 784         | 658                      | 396             | 410        | 1,266      | 176        | 672                | 4,362       |
| Unrated (2)              | —                                               | 148         | 29                       | 146             | 56         | 170        | 423        | 263                | 1,235       |
|                          | 28,024                                          | 5,489       | 2,679                    | 901             | 3,336      | 1,819      | 5,065      | 4,973              | 52,286      |

##### Notes:

(1) Includes US agency and Dutch government guaranteed securities.

(2) Includes held-for-trading.

## Financial review *Risk and balance sheet management*

### Equity shares

The table below analyses holdings of equity shares for eurozone countries and other countries with balances more than £100 million by country, issuer and measurement classification. The HFT portfolios in Markets comprise positions in the Markets Derivative Products Solutions business primarily for economic hedging of liabilities including debt issuances and equity derivatives. The AFS portfolios include capital stock in the Federal Home Loans Bank (a government sponsored entity, included in other financial institutions) and the Federal Reserve Bank together £0.6 billion (2012 - £0.7 billion), that US Retail & Commercial are required to hold and a number of individually small holdings in unlisted companies, mainly acquired through loan renegotiations in GRG.

| Countries          | 2013        |                                        |                 |                 |                           |             |                                    |                 |                     |             |                    |
|--------------------|-------------|----------------------------------------|-----------------|-----------------|---------------------------|-------------|------------------------------------|-----------------|---------------------|-------------|--------------------|
|                    | HFT         |                                        |                 |                 | HFT short positions<br>£m | AFS/DFV (1) |                                    |                 |                     | Total<br>£m | AFS reserves<br>£m |
|                    | Banks<br>£m | Other financial institutions (2)<br>£m | Corporate<br>£m | Total HFT<br>£m |                           | Banks<br>£m | Other financial institutions<br>£m | Corporate<br>£m | Total AFS/DFV<br>£m |             |                    |
| Spain              | 4           | —                                      | 56              | 60              | (2)                       | —           | —                                  | 60              | 60                  | 120         | (6)                |
| Ireland            | —           | 73                                     | 22              | 95              | —                         | —           | 7                                  | 2               | 9                   | 104         | —                  |
| Italy              | 7           | 1                                      | 26              | 34              | (1)                       | —           | 5                                  | —               | 5                   | 39          | —                  |
| Portugal           | —           | —                                      | 4               | 4               | —                         | —           | —                                  | —               | —                   | 4           | —                  |
| Greece             | —           | —                                      | 1               | 1               | —                         | —           | —                                  | —               | —                   | 1           | —                  |
| Eurozone periphery | 11          | 74                                     | 109             | 194             | (3)                       | —           | 12                                 | 62              | 74                  | 268         | (6)                |
| Netherlands        | 1           | 139                                    | 399             | 539             | (2)                       | —           | —                                  | —               | —                   | 539         | —                  |
| France             | 3           | 6                                      | 130             | 139             | (2)                       | 4           | —                                  | 147             | 151                 | 290         | 30                 |
| Luxembourg         | —           | 218                                    | 35              | 253             | (34)                      | —           | —                                  | 1               | 1                   | 254         | —                  |
| Germany            | 9           | 42                                     | 181             | 232             | (20)                      | —           | —                                  | —               | —                   | 232         | —                  |
| Other              | 11          | 18                                     | 117             | 146             | (17)                      | 4           | —                                  | —               | 4                   | 150         | 1                  |
| Total eurozone     | 35          | 497                                    | 971             | 1,503           | (78)                      | 8           | 12                                 | 210             | 230                 | 1,733       | 25                 |
| US                 | 20          | 425                                    | 1,088           | 1,533           | (31)                      | 165         | 347                                | 36              | 548                 | 2,081       | 12                 |
| UK                 | 117         | 70                                     | 1,359           | 1,546           | (96)                      | —           | 263                                | 153             | 416                 | 1,962       | 55                 |
| Japan              | 9           | 295                                    | 686             | 990             | (8)                       | —           | 1                                  | —               | 1                   | 991         | —                  |
| China              | 140         | 39                                     | 135             | 314             | —                         | —           | —                                  | —               | —                   | 314         | —                  |
| Australia          | 75          | 50                                     | 83              | 208             | —                         | —           | —                                  | 4               | 4                   | 212         | —                  |
| Switzerland        | 10          | 11                                     | 78              | 99              | (8)                       | —           | 47                                 | —               | 47                  | 146         | 39                 |
| Hong Kong          | 2           | 56                                     | 72              | 130             | —                         | —           | —                                  | 7               | 7                   | 137         | 5                  |
| Russia             | 13          | 3                                      | 88              | 104             | —                         | —           | —                                  | —               | —                   | 104         | —                  |
| Other              | 67          | 69                                     | 420             | 556             | (35)                      | —           | —                                  | 42              | 42                  | 598         | 4                  |
| Total              | 488         | 1,515                                  | 4,980           | 6,983           | (256)                     | 173         | 670                                | 452             | 1,295               | 8,278       | 140                |

For the notes to this table refer to page 137.



## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued Equity shares continued

| Countries                                  | 2012        |                                           |                 |                    |                              |             |                                       |                 |                        |             |                    |
|--------------------------------------------|-------------|-------------------------------------------|-----------------|--------------------|------------------------------|-------------|---------------------------------------|-----------------|------------------------|-------------|--------------------|
|                                            | HFT         |                                           |                 |                    |                              | AFS/DFV (1) |                                       |                 |                        |             | AFS reserves<br>£m |
|                                            | Banks<br>£m | Other financial<br>institutions (2)<br>£m | Corporate<br>£m | Total<br>HFT<br>£m | HFT short<br>positions<br>£m | Banks<br>£m | Other financial<br>institutions<br>£m | Corporate<br>£m | Total<br>AFS/DFV<br>£m | Total<br>£m |                    |
| Spain                                      | 18          | —                                         | 51              | 69                 | —                            | —           | —                                     | 92              | 92                     | 161         | (41)               |
| Ireland                                    | —           | 126                                       | 35              | 161                | (3)                          | —           | 16                                    | —               | 16                     | 177         | —                  |
| Italy                                      | 7           | 1                                         | 33              | 41                 | (15)                         | —           | 5                                     | —               | 5                      | 46          | —                  |
| Portugal                                   | —           | —                                         | 5               | 5                  | —                            | —           | —                                     | —               | —                      | 5           | —                  |
| Greece                                     | —           | —                                         | 6               | 6                  | —                            | —           | —                                     | —               | —                      | 6           | —                  |
| Eurozone periphery                         | 25          | 127                                       | 130             | 282                | (18)                         | —           | 21                                    | 92              | 113                    | 395         | (41)               |
| Netherlands                                | 14          | 105                                       | 365             | 484                | (20)                         | —           | —                                     | —               | —                      | 484         | —                  |
| France                                     | 10          | 75                                        | 101             | 186                | (10)                         | —           | —                                     | 143             | 143                    | 329         | 22                 |
| Luxembourg                                 | 14          | 195                                       | 38              | 247                | (1)                          | —           | —                                     | 34              | 34                     | 281         | —                  |
| Germany                                    | 33          | 1                                         | 70              | 104                | (54)                         | —           | —                                     | —               | —                      | 104         | —                  |
| Other                                      | 18          | 15                                        | 116             | 149                | (15)                         | —           | —                                     | —               | —                      | 149         | —                  |
| Total eurozone                             | 114         | 518                                       | 820             | 1,452              | (118)                        | —           | 21                                    | 269             | 290                    | 1,742       | (19)               |
| US                                         | 208         | 586                                       | 2,585           | 3,379              | (126)                        | 307         | 411                                   | 18              | 736                    | 4,115       | 6                  |
| UK                                         | 342         | 104                                       | 2,484           | 2,930              | (33)                         | 35          | 54                                    | 226             | 315                    | 3,245       | 28                 |
| Japan                                      | 24          | 66                                        | 973             | 1,063              | (1)                          | —           | 2                                     | —               | 2                      | 1,065       | —                  |
| China                                      | 208         | 3                                         | 257             | 468                | (3)                          | —           | 14                                    | 3               | 17                     | 485         | 7                  |
| Australia                                  | 77          | 45                                        | 159             | 281                | (17)                         | —           | —                                     | —               | —                      | 281         | —                  |
| Switzerland                                | 4           | —                                         | 71              | 75                 | (13)                         | —           | 34                                    | —               | 34                     | 109         | 31                 |
| Hong Kong                                  | 2           | 81                                        | 97              | 180                | —                            | —           | —                                     | 4               | 4                      | 184         | 1                  |
| Russia                                     | 16          | 4                                         | 158             | 178                | —                            | —           | —                                     | —               | —                      | 178         | —                  |
| Other                                      | 132         | 300                                       | 1,873           | 2,305              | (290)                        | —           | 1                                     | 162             | 163                    | 2,468       | 3                  |
| Total excluding<br>discontinued operations | 1,127       | 1,707                                     | 9,477           | 12,311             | (601)                        | 342         | 537                                   | 682             | 1,561                  | 13,872      | 57                 |
| Discontinued operations                    | —           | —                                         | —               | —                  | —                            | —           | 5                                     | —               | 5                      | 5           | (2)                |
| Total including<br>discontinued operations | 1,127       | 1,707                                     | 9,477           | 12,311             | (601)                        | 342         | 542                                   | 682             | 1,566                  | 13,877      | 55                 |

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

## Financial review *Risk and balance sheet management*

| Countries                               | 2011  |                                  |           |           |                     |             |                              |           |               |        |              |
|-----------------------------------------|-------|----------------------------------|-----------|-----------|---------------------|-------------|------------------------------|-----------|---------------|--------|--------------|
|                                         | HFT   |                                  |           |           | HFT short positions | AFS/DFV (1) |                              |           |               | Total  | AFS reserves |
|                                         | Banks | Other financial institutions (2) | Corporate | Total HFT |                     | Banks       | Other financial institutions | Corporate | Total AFS/DFV |        |              |
|                                         | £m    | £m                               | £m        | £m        | £m                  | £m          | £m                           | £m        | £m            | £m     | £m           |
| Spain                                   | 54    | 2                                | 9         | 65        | (16)                | —           | —                            | 136       | 136           | 201    | (4)          |
| Ireland                                 | —     | —                                | 208       | 208       | (4)                 | —           | 6                            | —         | 6             | 214    | —            |
| Italy                                   | 11    | —                                | 49        | 60        | (4)                 | —           | 5                            | —         | 5             | 65     | —            |
| Portugal                                | —     | —                                | —         | —         | (1)                 | —           | —                            | 5         | 5             | 5      | —            |
| Eurozone periphery                      | 65    | 2                                | 266       | 333       | (25)                | —           | 11                           | 141       | 152           | 485    | (4)          |
| Netherlands                             | —     | 17                               | 453       | 470       | (22)                | —           | —                            | 2         | 2             | 472    | —            |
| France                                  | 11    | 2                                | 85        | 98        | (59)                | 3           | —                            | 122       | 125           | 223    | 19           |
| Luxembourg                              | —     | 1                                | 57        | 58        | —                   | —           | —                            | 2         | 2             | 60     | —            |
| Germany                                 | 23    | 1                                | 91        | 115       | (151)               | —           | —                            | —         | —             | 115    | —            |
| Other                                   | 18    | 13                               | 93        | 124       | (61)                | —           | 5                            | 1         | 6             | 130    | 5            |
| Total eurozone                          | 117   | 36                               | 1,045     | 1,198     | (318)               | 3           | 16                           | 268       | 287           | 1,485  | 20           |
| US                                      | 118   | 67                               | 1,324     | 1,509     | (544)               | 323         | 494                          | 103       | 920           | 2,429  | 62           |
| UK                                      | 383   | 199                              | 2,565     | 3,147     | (141)               | 33          | 146                          | 243       | 422           | 3,569  | 55           |
| Japan                                   | 43    | 82                               | 1,284     | 1,409     | (3)                 | —           | 1                            | —         | 1             | 1,410  | —            |
| China                                   | 320   | 132                              | 380       | 832       | (6)                 | —           | 12                           | —         | 12            | 844    | 4            |
| Australia                               | 18    | 5                                | 75        | 98        | (120)               | —           | —                            | 15        | 15            | 113    | 2            |
| Switzerland                             | 9     | 8                                | 198       | 215       | (42)                | —           | —                            | 15        | 15            | 230    | 14           |
| Hong Kong                               | 9     | 36                               | 76        | 121       | (2)                 | —           | —                            | 3         | 3             | 124    | 1            |
| Russia                                  | 25    | —                                | 184       | 209       | (2)                 | —           | —                            | —         | —             | 209    | —            |
| Other                                   | 47    | 251                              | 804       | 1,102     | (484)               | —           | —                            | 242       | 242           | 1,344  | (3)          |
| Total excluding discontinued operations | 1,089 | 816                              | 7,935     | 9,840     | (1,662)             | 359         | 669                          | 889       | 1,917         | 11,757 | 155          |
| Discontinued operations                 | —     | 5                                | —         | 5         | —                   | —           | —                            | —         | —             | 5      | (2)          |
| Total including discontinued operations | 1,089 | 821                              | 7,935     | 9,845     | (1,662)             | 359         | 669                          | 889       | 1,917         | 11,762 | 153          |

### Notes:

(1) Designated as at fair value through profit or loss (DFV) balances are £312 million (2012 - £484 million; 2011 - £575 million) of which nil banks (2012 and 2011 - nil), £66 million other financial institutions (2012 - £13 million; 2011 - £10 million) and £246 million corporate (2012 - £471 million; 2011 - £565 million).

(2) Includes government sponsored entities.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### Derivatives

The table below analyses the fair value of the Group's derivatives by type of contract. Master netting arrangements in respect of mark-to-market (mtm) positions and collateral shown below do not result in a net presentation in the Group's balance sheet under IFRS.

|                                | 2013            |               |                   | 2012            |               |                   | 2011            |               |                   |
|--------------------------------|-----------------|---------------|-------------------|-----------------|---------------|-------------------|-----------------|---------------|-------------------|
|                                | Notional<br>£bn | Assets<br>£m  | Liabilities<br>£m | Notional<br>£bn | Assets<br>£m  | Liabilities<br>£m | Notional<br>£bn | Assets<br>£m  | Liabilities<br>£m |
| Interest rate (1)              | 35,571          | 216,574       | 207,583           | 33,368          | 360,928       | 343,328           | 38,569          | 418,971       | 403,391           |
| Exchange rate                  | 4,529           | 61,389        | 64,993            | 4,637           | 61,707        | 69,102            | 4,364           | 71,465        | 78,138            |
| Credit                         | 252             | 5,241         | 5,375             | 551             | 10,918        | 10,290            | 1,047           | 26,739        | 26,417            |
| Equity and commodity contracts | 80              | 2,787         | 5,597             | 112             | 4,348         | 7,785             | 114             | 5,252         | 8,513             |
|                                |                 | 285,991       | 283,548           |                 | 437,901       | 430,505           |                 | 522,427       | 516,459           |
| Counterparty mtm netting       |                 | (242,804)     | (242,804)         |                 | (373,767)     | (373,767)         |                 | (440,947)     | (440,947)         |
| Cash collateral                |                 | (23,579)      | (20,408)          |                 | (33,440)      | (24,546)          |                 | (36,358)      | (30,345)          |
| Securities collateral          |                 | (5,990)       | (5,202)           |                 | (5,616)       | (8,264)           |                 | (5,312)       | (8,585)           |
|                                |                 | <u>13,618</u> | <u>15,134</u>     |                 | <u>25,078</u> | <u>23,928</u>     |                 | <u>39,810</u> | <u>36,582</u>     |
| Balances with Group companies  | 56              | 3,413         | 2,586             | 134             | 7,200         | 5,580             | 231             | 10,380        | 11,377            |

Note:

(1) Interest rate notional includes £22,563 billion (2012 - £15,863 billion) relating to contracts with central clearing houses.

#### Credit derivatives

The Group trades credit derivatives as part of its client led business and to mitigate credit risk. The Group's credit derivative exposures relating to proprietary trading are minimal. The table below analyses the Group's bought and sold protection.

| Group                                | 2013          |              |               |             | 2012          |              |               |             | 2011          |              |               |             |
|--------------------------------------|---------------|--------------|---------------|-------------|---------------|--------------|---------------|-------------|---------------|--------------|---------------|-------------|
|                                      | Notional      |              | Fair value    |             | Notional      |              | Fair value    |             | Notional      |              | Fair value    |             |
|                                      | Bought<br>£bn | Sold<br>£bn  | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn  | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn  | Bought<br>£bn | Sold<br>£bn |
| Client-led trading and residual risk | 124.4         | 111.7        | 1.2           | 1.5         | 250.5         | 240.4        | 3.4           | 3.2         | 400.3         | 390.4        | 17.0          | 16.5        |
| Credit hedging - banking book (1)    | 2.3           | 0.2          | 0.2           | —           | 5.4           | 0.4          | 0.1           | —           | 14.8          | 4.3          | 0.1           | 0.1         |
| Credit hedging - trading book        |               |              |               |             |               |              |               |             |               |              |               |             |
| - rates                              | 5.1           | 4.0          | 0.1           | 0.1         | 9.4           | 5.8          | 0.1           | 0.1         | 21.0          | 17.1         | 0.9           | 1.7         |
| - credit and mortgage markets        | 2.2           | 1.4          | 0.5           | 0.3         | 21.6          | 15.6         | 0.9           | 0.6         | 40.7          | 25.7         | 2.1           | 1.3         |
| - other                              | 0.8           | 0.1          | —             | —           | 1.2           | 0.4          | —             | —           | 0.9           | 0.1          | —             | —           |
| Total excluding APS                  | 134.8         | 117.4        | 2.0           | 1.9         | 288.1         | 262.6        | 4.5           | 3.9         | 477.7         | 437.6        | 20.1          | 19.6        |
| APS                                  | —             | —            | —             | —           | —             | —            | —             | —           | 131.8         | —            | (0.2)         | —           |
|                                      | <u>134.8</u>  | <u>117.4</u> | <u>2.0</u>    | <u>1.9</u>  | <u>288.1</u>  | <u>262.6</u> | <u>4.5</u>    | <u>3.9</u>  | <u>609.5</u>  | <u>437.6</u> | <u>19.9</u>   | <u>19.6</u> |
| Core                                 |               |              |               |             |               |              |               |             |               |              |               |             |
| Client-led trading                   | 103.8         | 99.1         | 1.1           | 1.3         | 231.1         | 228.1        | 3.0           | 2.8         | 370.5         | 369.4        | 14.6          | 14.0        |
| Credit hedging - banking book        | 1.3           | —            | —             | —           | 1.7           | —            | —             | —           | 2.2           | 0.9          | —             | 0.1         |
| Credit hedging - trading book        |               |              |               |             |               |              |               |             |               |              |               |             |
| - rates                              | 4.4           | 3.5          | 0.1           | 0.1         | 7.8           | 4.6          | 0.1           | 0.1         | 19.7          | 16.2         | 0.9           | 1.7         |
| - credit and mortgage markets        | 0.2           | —            | —             | —           | 13.7          | 13.6         | 0.2           | 0.2         | 3.9           | 3.1          | 0.2           | 0.1         |
| - other                              | 0.7           | 0.1          | —             | —           | 1.1           | 0.3          | —             | —           | 0.8           | 0.1          | —             | —           |
|                                      | <u>110.4</u>  | <u>102.7</u> | <u>1.2</u>    | <u>1.4</u>  | <u>255.4</u>  | <u>246.6</u> | <u>3.3</u>    | <u>3.1</u>  | <u>397.1</u>  | <u>389.7</u> | <u>15.7</u>   | <u>15.9</u> |
| Non-Core                             |               |              |               |             |               |              |               |             |               |              |               |             |
| Residual risk                        | 20.6          | 12.6         | 0.1           | 0.2         | 19.4          | 12.3         | 0.4           | 0.4         | 29.8          | 21.0         | 2.4           | 2.5         |
| Credit hedging - banking book (1)    | 1.0           | 0.2          | 0.2           | —           | 3.7           | 0.4          | 0.1           | —           | 12.6          | 3.4          | 0.1           | —           |
| Credit hedging - trading book        |               |              |               |             |               |              |               |             |               |              |               |             |
| - rates                              | 0.7           | 0.5          | —             | —           | 1.6           | 1.2          | —             | —           | 1.3           | 0.9          | —             | —           |
| - credit and mortgage markets        | 2.0           | 1.4          | 0.5           | 0.3         | 7.9           | 2.0          | 0.7           | 0.4         | 36.8          | 22.6         | 1.9           | 1.2         |
| - other                              | 0.1           | —            | —             | —           | 0.1           | 0.1          | —             | —           | 0.1           | —            | —             | —           |
|                                      | <u>24.4</u>   | <u>14.7</u>  | <u>0.8</u>    | <u>0.5</u>  | <u>32.7</u>   | <u>16.0</u>  | <u>1.2</u>    | <u>0.8</u>  | <u>80.6</u>   | <u>47.9</u>  | <u>4.4</u>    | <u>3.7</u>  |

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

## Financial review *Risk and balance sheet management*

|                              | 2013          |             |               |             | 2012          |             |               |             | 2011          |             |               |             |
|------------------------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|---------------|-------------|
|                              | Notional      |             | Fair value    |             | Notional      |             | Fair value    |             | Notional      |             | Fair value    |             |
|                              | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn | Bought<br>£bn | Sold<br>£bn |
| <i>By counterparty</i>       |               |             |               |             |               |             |               |             |               |             |               |             |
| Central government (APS)     | —             | —           | —             | —           | —             | —           | —             | —           | 131.8         | —           | (0.2)         | —           |
| Monoline insurers            | 1.4           | —           | 0.1           | —           | 4.2           | —           | 0.3           | —           | 8.0           | —           | 0.6           | —           |
| CDPCs (2)                    | 18.9          | —           | 0.1           | —           | 21.0          | —           | 0.2           | —           | 24.5          | —           | 0.9           | —           |
| Banks                        | 49.2          | 55.8        | 1.2           | 1.9         | 127.0         | 128.4       | 2.5           | 2.8         | 203.5         | 200.5       | 8.5           | 9.9         |
| Other financial institutions | 64.6          | 61.6        | 0.4           | —           | 135.2         | 134.2       | 1.3           | 1.1         | 232.9         | 230.6       | 10.2          | 9.5         |
| Corporates                   | 0.7           | —           | 0.2           | —           | 0.7           | —           | 0.2           | —           | 8.8           | 6.5         | (0.1)         | 0.2         |
|                              | 134.8         | 117.4       | 2.0           | 1.9         | 288.1         | 262.6       | 4.5           | 3.9         | 609.5         | 437.6       | 19.9          | 19.6        |

Notes:

(1) Credit hedging in the banking book principally relates to portfolio management in Non-Core.

(2) Credit derivative product company.

### *Monoline insurers*

The table below summarises the Group's monoline exposures.

|      | Notional:<br>Protected<br>assets<br>£m | Fair value:<br>reference<br>protected<br>assets<br>£m | Gross<br>Exposure<br>£m | Credit<br>valuation<br>adjustment<br>£m | Hedges<br>£m | Net<br>exposure<br>£m | Counterparty and<br>credit risk RWAs<br>£m |
|------|----------------------------------------|-------------------------------------------------------|-------------------------|-----------------------------------------|--------------|-----------------------|--------------------------------------------|
| 2013 | 1,392                                  | 1,218                                                 | 174                     | 53                                      | —            | 121                   | 0.7                                        |
| 2012 | 4,237                                  | 3,704                                                 | 533                     | 181                                     | 12           | 340                   | 1.2                                        |
| 2011 | 7,964                                  | 6,296                                                 | 1,668                   | 1,012                                   | 71           | 585                   | 3.5                                        |

### *Credit derivative product companies (CDPCs)*

The table below summarises the Group's exposures to CDPCs, all of which are in Non-Core.

|      | Notional:<br>protected<br>assets<br>£m | Fair value:<br>reference<br>protected<br>assets<br>£m | Gross<br>Exposure<br>£m | Valuation<br>adjustment<br>£m | Net<br>exposure<br>£m | Counterparty and<br>credit risk RWAs<br>£m |
|------|----------------------------------------|-------------------------------------------------------|-------------------------|-------------------------------|-----------------------|--------------------------------------------|
| 2013 | 18,827                                 | 18,729                                                | 98                      | 40                            | 58                    | 0.7                                        |
| 2012 | 20,989                                 | 20,435                                                | 554                     | 314                           | 240                   | 2.0                                        |
| 2011 | 24,504                                 | 22,608                                                | 1,896                   | 1,034                         | 862                   | 8.4                                        |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions

Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including loans subject to forbearance) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

#### Divisional analysis

The following tables analyse loans and advances to banks and customers (excluding reverse repos) and the related debt management measures and ratios by division.

|                                                          | Group          |           |        |            |                                         |                           |                   |                     |
|----------------------------------------------------------|----------------|-----------|--------|------------|-----------------------------------------|---------------------------|-------------------|---------------------|
|                                                          | Gross loans to |           | REIL   | Provisions | Credit metrics                          |                           | Impairment charge | Amounts written-off |
|                                                          | Banks          | Customers |        |            | REIL as a % of gross loans to customers | Provisions as a % of REIL |                   |                     |
|                                                          | £m             | £m        | £m     | £m         | %                                       | %                         | £m                | £m                  |
| 2013                                                     |                |           |        |            |                                         |                           |                   |                     |
| UK Retail                                                | 716            | 113,152   | 3,566  | 2,106      | 3.2                                     | 59                        | 320               | 815                 |
| UK Corporate                                             | 701            | 102,547   | 6,226  | 2,833      | 6.1                                     | 46                        | 1,188             | 772                 |
| Wealth                                                   | 1,531          | 16,743    | 277    | 120        | 1.7                                     | 43                        | 29                | 15                  |
| International Banking                                    | 7,190          | 34,083    | 424    | 298        | 1.2                                     | 70                        | 223               | 260                 |
| Ulster Bank                                              | 591            | 31,446    | 8,466  | 5,378      | 26.9                                    | 64                        | 1,774             | 277                 |
| US Retail & Commercial                                   | 406            | 50,551    | 1,034  | 272        | 2.0                                     | 26                        | 151               | 284                 |
| Retail & Commercial                                      | 11,135         | 348,522   | 19,993 | 11,007     | 5.7                                     | 55                        | 3,685             | 2,423               |
| Markets                                                  | 11,694         | 24,996    | 338    | 286        | 1.4                                     | 85                        | 24                | 45                  |
| Other                                                    | 1,942          | 5,128     | —      | 65         | —                                       | nm                        | 65                | —                   |
| Core                                                     | 24,771         | 378,646   | 20,331 | 11,358     | 5.4                                     | 56                        | 3,774             | 2,468               |
| Non-Core                                                 | 292            | 34,618    | 18,795 | 13,696     | 54.3                                    | 73                        | 4,691             | 1,756               |
| Total third-party                                        | 25,063         | 413,264   | 39,126 | 25,054     | 9.5                                     | 64                        | 8,465             | 4,224               |
| Amounts due from holding company and fellow subsidiaries | 15,058         | 1,620     | —      | —          | —                                       | —                         | —                 | —                   |
|                                                          | 40,121         | 414,884   | 39,126 | 25,054     | 9.4                                     | 64                        | 8,465             | 4,224               |
| 2012                                                     |                |           |        |            |                                         |                           |                   |                     |
| UK Retail                                                | 640            | 113,599   | 4,569  | 2,629      | 4.0                                     | 58                        | 529               | 599                 |
| UK Corporate                                             | 746            | 107,025   | 5,452  | 2,432      | 5.1                                     | 45                        | 836               | 514                 |
| Wealth                                                   | 1,545          | 17,062    | 248    | 109        | 1.5                                     | 44                        | 46                | 15                  |
| International Banking                                    | 4,432          | 39,011    | 358    | 336        | 0.9                                     | 94                        | 131               | 332                 |
| Ulster Bank                                              | 632            | 32,652    | 7,533  | 3,910      | 23.1                                    | 52                        | 1,364             | 72                  |
| US Retail & Commercial                                   | 435            | 51,271    | 1,146  | 285        | 2.2                                     | 25                        | 83                | 391                 |
| Retail & Commercial                                      | 8,430          | 360,620   | 19,306 | 9,701      | 5.4                                     | 50                        | 2,989             | 1,923               |
| Markets                                                  | 15,247         | 29,046    | 394    | 301        | 1.4                                     | 76                        | (12)              | 14                  |
| Other                                                    | 2,021          | 2,159     | —      | -          | —                                       | —                         | —                 | —                   |
| Core                                                     | 25,698         | 391,825   | 19,700 | 10,002     | 5.0                                     | 51                        | 2,977             | 1,937               |
| Non-Core                                                 | 164            | 51,796    | 20,824 | 10,805     | 40.2                                    | 52                        | 2,304             | 1,950               |
| Total third-party                                        | 25,862         | 443,621   | 40,524 | 20,807     | 9.1                                     | 51                        | 5,281             | 3,887               |
| Amounts due from holding company and fellow subsidiaries | 21,875         | 1,866     | —      | —          | —                                       | —                         | —                 | —                   |
|                                                          | 47,737         | 445,487   | 40,524 | 20,807     | 9.1                                     | 51                        | 5,281             | 3,887               |

## Financial review *Risk and balance sheet management*

|                                                             | Group          |           |        |            |                                               |                                 |                      |                        |
|-------------------------------------------------------------|----------------|-----------|--------|------------|-----------------------------------------------|---------------------------------|----------------------|------------------------|
|                                                             |                |           |        |            | Credit metrics                                |                                 |                      |                        |
|                                                             | Gross loans to |           | REIL   | Provisions | REIL as a %<br>of gross loans<br>to customers | Provisions<br>as a %<br>of REIL | Impairment<br>charge | Amounts<br>written-off |
|                                                             | Banks          | Customers |        |            |                                               |                                 |                      |                        |
| 2011                                                        | £m             | £m        | £m     | £m         | %                                             | %                               | £m                   | £m                     |
| UK Retail                                                   | 628            | 103,377   | 4,087  | 2,344      | 4.0                                           | 57                              | 788                  | 823                    |
| UK Corporate                                                | 806            | 98,430    | 3,988  | 1,623      | 4.1                                           | 41                              | 790                  | 658                    |
| Wealth                                                      | 2,422          | 16,913    | 211    | 81         | 1.2                                           | 38                              | 25                   | 11                     |
| International Banking                                       | 2,122          | 39,562    | 982    | 329        | 2.5                                           | 34                              | (16)                 | 84                     |
| Ulster Bank                                                 | 2,079          | 34,052    | 5,523  | 2,749      | 16.2                                          | 50                              | 1,384                | 124                    |
| US Retail & Commercial                                      | 208            | 51,562    | 1,007  | 455        | 2.0                                           | 45                              | 248                  | 373                    |
| Retail & Commercial                                         | 8,265          | 343,896   | 15,798 | 7,581      | 4.6                                           | 48                              | 3,219                | 2,073                  |
| Markets                                                     | 23,569         | 29,346    | 214    | 170        | 0.7                                           | 79                              | (27)                 | 12                     |
| Other                                                       | 355            | 11        | —      | —          | —                                             | —                               | —                    | —                      |
| Core                                                        | 32,189         | 373,253   | 16,012 | 7,751      | 4.3                                           | 48                              | 3,192                | 2,085                  |
| Non-Core                                                    | 44             | 72,566    | 23,060 | 10,803     | 31.8                                          | 47                              | 3,777                | 2,098                  |
| Total third-party                                           | 32,233         | 445,819   | 39,072 | 18,554     | 8.8                                           | 47                              | 6,969                | 4,183                  |
| Amounts due from holding company<br>and fellow subsidiaries | 27,232         | 792       | —      | —          | —                                             | —                               | —                    | —                      |
|                                                             | 59,465         | 446,611   | 39,072 | 18,554     | 8.7                                           | 47                              | 6,969                | 4,183                  |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

##### Sector and geographical region analyses: Group

The following tables analyse gross loans and advances to banks and customers (excluding reverse repos) and the related debt management measures and ratios by sector and geography (by location of lending office) for the Group, Core and Non-Core.

| 2013                                                        | Group             |            |                  |                                       |                                      |                                             |                            |                              |
|-------------------------------------------------------------|-------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                             | Gross loans<br>£m | REIL<br>£m | Provisions<br>£m | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
| Central and local government                                | 7,976             | 2          | 2                | —                                     | 100                                  | —                                           | 2                          | —                            |
| Finance                                                     | 34,875            | 535        | 278              | 1.5                                   | 52                                   | 0.8                                         | 13                         | 43                           |
| Personal - mortgages                                        | 148,347           | 6,004      | 1,781            | 4.0                                   | 30                                   | 1.2                                         | 407                        | 436                          |
| - unsecured                                                 | 28,152            | 2,409      | 1,909            | 8.6                                   | 79                                   | 6.8                                         | 408                        | 855                          |
| Property                                                    | 62,249            | 20,244     | 13,156           | 32.5                                  | 65                                   | 21.1                                        | 5,125                      | 1,640                        |
| Construction                                                | 6,310             | 1,330      | 772              | 21.1                                  | 58                                   | 12.2                                        | 291                        | 160                          |
| Manufacturing                                               | 20,613            | 700        | 529              | 3.4                                   | 76                                   | 2.6                                         | 196                        | 78                           |
| Finance leases and instalment credit                        | 13,503            | 263        | 190              | 1.9                                   | 72                                   | 1.4                                         | 16                         | 121                          |
| Retail, wholesale and repairs                               | 19,330            | 1,167      | 773              | 6.0                                   | 66                                   | 4.0                                         | 270                        | 128                          |
| Transport and storage                                       | 16,427            | 1,490      | 634              | 9.1                                   | 43                                   | 3.9                                         | 484                        | 178                          |
| Health, education and leisure                               | 16,080            | 1,322      | 770              | 8.2                                   | 58                                   | 4.8                                         | 360                        | 120                          |
| Hotels and restaurants                                      | 6,936             | 1,427      | 812              | 20.6                                  | 57                                   | 11.7                                        | 281                        | 194                          |
| Utilities                                                   | 4,810             | 65         | 45               | 1.4                                   | 69                                   | 0.9                                         | 60                         | 23                           |
| Other                                                       | 27,656            | 2,099      | 1,343            | 7.6                                   | 64                                   | 4.9                                         | 494                        | 208                          |
| Latent                                                      | —                 | —          | 1,998            | —                                     | —                                    | —                                           | 73                         | —                            |
| Total third-party                                           | 413,264           | 39,057     | 24,992           | 9.5                                   | 64                                   | 6.0                                         | 8,480                      | 4,184                        |
| Amounts due from holding company<br>and fellow subsidiaries | 1,620             | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                             | 414,884           | 39,057     | 24,992           | 9.4                                   | 64                                   | 6.0                                         | 8,480                      | 4,184                        |
| of which:                                                   |                   |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                          |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                     | 110,515           | 1,901      | 318              | 1.7                                   | 17                                   | 0.3                                         | 38                         | 178                          |
| - personal lending                                          | 17,098            | 2,050      | 1,719            | 12.0                                  | 84                                   | 10.1                                        | 263                        | 680                          |
| - property                                                  | 44,232            | 9,776      | 5,176            | 22.1                                  | 53                                   | 11.7                                        | 2,011                      | 948                          |
| - construction                                              | 4,691             | 940        | 515              | 20.0                                  | 55                                   | 11.0                                        | 195                        | 159                          |
| - other                                                     | 109,474           | 4,687      | 3,201            | 4.3                                   | 68                                   | 2.9                                         | 1,090                      | 537                          |
| Europe                                                      |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                     | 17,354            | 3,135      | 1,286            | 18.1                                  | 41                                   | 7.4                                         | 196                        | 26                           |
| - personal lending                                          | 1,267             | 135        | 129              | 10.7                                  | 96                                   | 10.2                                        | 13                         | 24                           |
| - property                                                  | 13,174            | 10,373     | 7,951            | 78.7                                  | 77                                   | 60.4                                        | 3,129                      | 659                          |
| - construction                                              | 977               | 351        | 228              | 35.9                                  | 65                                   | 23.3                                        | 72                         | —                            |
| - other                                                     | 22,213            | 3,921      | 3,421            | 17.7                                  | 87                                   | 15.4                                        | 1,041                      | 403                          |
| US                                                          |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                     | 19,901            | 950        | 173              | 4.8                                   | 18                                   | 0.9                                         | 176                        | 230                          |
| - personal lending                                          | 8,722             | 207        | 44               | 2.4                                   | 21                                   | 0.5                                         | 115                        | 151                          |
| - property                                                  | 4,279             | 85         | 19               | 2.0                                   | 22                                   | 0.4                                         | (11)                       | 25                           |
| - construction                                              | 313               | 34         | 24               | 10.9                                  | 71                                   | 7.7                                         | 24                         | 1                            |
| - other                                                     | 27,853            | 198        | 589              | 0.7                                   | 297                                  | 2.1                                         | 71                         | 102                          |
| RoW                                                         |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                     | 577               | 18         | 4                | 3.1                                   | 22                                   | 0.7                                         | (3)                        | 2                            |
| - personal lending                                          | 1,065             | 17         | 17               | 1.6                                   | 100                                  | 1.6                                         | 17                         | —                            |
| - property                                                  | 564               | 10         | 10               | 1.8                                   | 100                                  | 1.8                                         | (4)                        | 8                            |
| - construction                                              | 329               | 5          | 5                | 1.5                                   | 100                                  | 1.5                                         | —                          | —                            |
| - other                                                     | 8,666             | 264        | 163              | 3.0                                   | 62                                   | 1.9                                         | 47                         | 51                           |
| Total third-party                                           | 413,264           | 39,057     | 24,992           | 9.5                                   | 64                                   | 6.0                                         | 8,480                      | 4,184                        |
| Amounts due from holding company<br>and fellow subsidiaries | 1,620             | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                             | 414,884           | 39,057     | 24,992           | 9.4                                   | 64                                   | 6.0                                         | 8,480                      | 4,184                        |
| Banks                                                       | 40,121            | 69         | 62               | 0.2                                   | 90                                   | 0.2                                         | (15)                       | 40                           |

## Financial review *Risk and balance sheet management*

|                                                          | Group                |            |                  |                                       |                                      |                                             |                            |                              |
|----------------------------------------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                          | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|                                                          |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2012                                                     |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government                             | 9,126                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                                                  | 41,037               | 503        | 218              | 1.2                                   | 43                                   | 0.5                                         | 88                         | 205                          |
| Personal - mortgages                                     | 149,210              | 6,498      | 1,779            | 4.4                                   | 27                                   | 1.2                                         | 943                        | 434                          |
| - unsecured                                              | 31,219               | 2,820      | 2,340            | 9.0                                   | 83                                   | 7.5                                         | 617                        | 785                          |
| Property                                                 | 72,109               | 21,179     | 9,822            | 29.4                                  | 46                                   | 13.6                                        | 2,232                      | 1,043                        |
| Construction                                             | 8,010                | 1,480      | 647              | 18.5                                  | 44                                   | 8.1                                         | 92                         | 174                          |
| Manufacturing                                            | 21,928               | 616        | 349              | 2.8                                   | 57                                   | 1.6                                         | 108                        | 146                          |
| Finance leases and instalment credit                     | 13,520               | 442        | 294              | 3.3                                   | 67                                   | 2.2                                         | 44                         | 263                          |
| Retail, wholesale and repairs                            | 21,425               | 1,117      | 624              | 5.2                                   | 56                                   | 2.9                                         | 222                        | 170                          |
| Transport and storage                                    | 17,822               | 832        | 334              | 4.7                                   | 40                                   | 1.9                                         | 288                        | 77                           |
| Health, education and leisure                            | 16,685               | 1,187      | 520              | 7.1                                   | 44                                   | 3.1                                         | 144                        | 95                           |
| Hotels and restaurants                                   | 7,820                | 1,597      | 726              | 20.4                                  | 45                                   | 9.3                                         | 176                        | 102                          |
| Utilities                                                | 6,288                | 35         | 13               | 0.6                                   | 37                                   | 0.2                                         | —                          | —                            |
| Other                                                    | 27,422               | 2,084      | 1,106            | 7.6                                   | 53                                   | 4.0                                         | 329                        | 379                          |
| Latent                                                   | —                    | —          | 1,921            | —                                     | —                                    | —                                           | (13)                       | —                            |
| Total third-party                                        | 443,621              | 40,390     | 20,693           | 9.1                                   | 51                                   | 4.7                                         | 5,270                      | 3,873                        |
| Amounts due from holding company and fellow subsidiaries | 1,866                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 445,487              | 40,390     | 20,693           | 9.1                                   | 51                                   | 4.6                                         | 5,270                      | 3,873                        |
| of which:                                                |                      |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 109,530              | 2,439      | 456              | 2.2                                   | 19                                   | 0.4                                         | 122                        | 32                           |
| - personal lending                                       | 19,691               | 2,477      | 2,152            | 12.6                                  | 87                                   | 10.9                                        | 479                        | 610                          |
| - property                                               | 53,704               | 10,495     | 3,935            | 19.5                                  | 37                                   | 7.3                                         | 960                        | 490                          |
| - construction                                           | 6,507                | 1,166      | 481              | 17.9                                  | 41                                   | 7.4                                         | 100                        | 158                          |
| - other                                                  | 120,808              | 3,719      | 2,608            | 3.1                                   | 70                                   | 2.2                                         | 675                        | 823                          |
| Europe                                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 17,451               | 3,060      | 1,125            | 17.5                                  | 37                                   | 6.4                                         | 521                        | 24                           |
| - personal lending                                       | 1,727                | 143        | 139              | 8.3                                   | 97                                   | 8.0                                         | 29                         | 12                           |
| - property                                               | 14,571               | 10,349     | 5,758            | 71.0                                  | 56                                   | 39.5                                        | 1,288                      | 404                          |
| - construction                                           | 1,109                | 300        | 160              | 27.1                                  | 53                                   | 14.4                                        | (13)                       | 4                            |
| - other                                                  | 25,099               | 4,231      | 2,834            | 16.9                                  | 67                                   | 11.3                                        | 816                        | 331                          |
| US                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 21,911               | 972        | 190              | 4.4                                   | 20                                   | 0.9                                         | 298                        | 376                          |
| - personal lending                                       | 8,748                | 199        | 48               | 2.3                                   | 24                                   | 0.5                                         | 109                        | 162                          |
| - property                                               | 3,343                | 170        | 29               | 5.1                                   | 17                                   | 0.9                                         | (11)                       | 83                           |
| - construction                                           | 388                  | 8          | 1                | 2.1                                   | 13                                   | 0.3                                         | —                          | 12                           |
| - other                                                  | 28,959               | 316        | 597              | 1.1                                   | 189                                  | 2.1                                         | (107)                      | 135                          |
| RoW                                                      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 318                  | 27         | 8                | 8.5                                   | 30                                   | 2.5                                         | 2                          | 2                            |
| - personal lending                                       | 1,053                | 1          | 1                | 0.1                                   | 100                                  | 0.1                                         | —                          | 1                            |
| - property                                               | 491                  | 165        | 100              | 33.6                                  | 61                                   | 20.4                                        | (5)                        | 66                           |
| - construction                                           | 6                    | 6          | 5                | 100.0                                 | 83                                   | 83.3                                        | 5                          | —                            |
| - other                                                  | 8,207                | 147        | 66               | 1.8                                   | 45                                   | 0.8                                         | 2                          | 148                          |
| Total third-party                                        | 443,621              | 40,390     | 20,693           | 9.1                                   | 51                                   | 4.7                                         | 5,270                      | 3,873                        |
| Amounts due from holding company and fellow subsidiaries | 1,866                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 445,487              | 40,390     | 20,693           | 9.1                                   | 51                                   | 4.6                                         | 5,270                      | 3,873                        |
| Banks                                                    | 47,737               | 134        | 114              | 0.3                                   | 85                                   | 0.2                                         | 11                         | 14                           |



## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

|                                                          | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|----------------------------------------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                          |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2011                                                     |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government                             | 8,854                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                                                  | 45,070               | 432        | 238              | 1.0                                   | 55                                   | 0.5                                         | (121)                      | 50                           |
| Personal - mortgages                                     | 142,676              | 5,000      | 1,313            | 3.5                                   | 26                                   | 0.9                                         | 1,046                      | 516                          |
| - unsecured                                              | 31,481               | 2,668      | 2,114            | 8.5                                   | 79                                   | 6.7                                         | 749                        | 1,182                        |
| Property                                                 | 76,003               | 21,563     | 8,781            | 28.4                                  | 41                                   | 11.6                                        | 3,702                      | 1,171                        |
| Construction                                             | 8,681                | 1,749      | 693              | 20.1                                  | 40                                   | 8.0                                         | 139                        | 244                          |
| Manufacturing                                            | 22,065               | 542        | 298              | 2.5                                   | 55                                   | 1.4                                         | 210                        | 179                          |
| Finance leases and instalment credit                     | 14,414               | 794        | 508              | 5.5                                   | 64                                   | 3.5                                         | 112                        | 170                          |
| Retail, wholesale and repairs                            | 20,175               | 950        | 468              | 4.7                                   | 49                                   | 2.3                                         | 175                        | 151                          |
| Transport and storage                                    | 20,251               | 552        | 122              | 2.7                                   | 22                                   | 0.6                                         | 76                         | 43                           |
| Health, education and leisure                            | 14,542               | 1,048      | 432              | 7.2                                   | 41                                   | 3.0                                         | 304                        | 98                           |
| Hotels and restaurants                                   | 8,229                | 1,437      | 643              | 17.5                                  | 45                                   | 7.8                                         | 334                        | 131                          |
| Utilities                                                | 6,586                | 52         | 9                | 0.8                                   | 17                                   | 0.1                                         | 3                          | 3                            |
| Other                                                    | 26,792               | 2,191      | 966              | 8.2                                   | 44                                   | 3.6                                         | 737                        | 245                          |
| Latent                                                   | —                    | —          | 1,884            | —                                     | —                                    | —                                           | (497)                      | —                            |
| Total third-party                                        | 445,819              | 38,978     | 18,469           | 8.7                                   | 47                                   | 4.1                                         | 6,969                      | 4,183                        |
| Amounts due from holding company and fellow subsidiaries | 792                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 446,611              | 38,978     | 18,469           | 8.7                                   | 47                                   | 4.1                                         | 6,969                      | 4,183                        |
| of which:                                                |                      |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 100,725              | 2,076      | 397              | 2.1                                   | 19                                   | 0.4                                         | 180                        | 25                           |
| - personal lending                                       | 19,345               | 2,384      | 1,925            | 12.3                                  | 81                                   | 10.0                                        | 645                        | 1,007                        |
| - property                                               | 55,727               | 7,854      | 2,852            | 14.1                                  | 36                                   | 5.1                                         | 1,407                      | 490                          |
| - construction                                           | 7,173                | 1,245      | 502              | 17.4                                  | 40                                   | 7.0                                         | 190                        | 228                          |
| - other                                                  | 123,114              | 3,598      | 2,456            | 2.9                                   | 68                                   | 2.0                                         | 536                        | 658                          |
| Europe                                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 18,334               | 2,121      | 664              | 11.6                                  | 31                                   | 3.6                                         | 437                        | 10                           |
| - personal lending                                       | 2,188                | 140        | 122              | 6.4                                   | 87                                   | 5.6                                         | (8)                        | 22                           |
| - property                                               | 15,771               | 13,007     | 5,696            | 82.5                                  | 44                                   | 36.1                                        | 2,334                      | 508                          |
| - construction                                           | 1,042                | 382        | 181              | 36.7                                  | 47                                   | 17.4                                        | (60)                       | (1)                          |
| - other                                                  | 21,751               | 3,795      | 2,155            | 17.4                                  | 57                                   | 9.9                                         | 997                        | 240                          |
| US                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 23,237               | 770        | 240              | 3.3                                   | 31                                   | 1.0                                         | 426                        | 481                          |
| - personal lending                                       | 8,441                | 143        | 66               | 1.7                                   | 46                                   | 0.8                                         | 112                        | 153                          |
| - property                                               | 3,777                | 329        | 92               | 8.7                                   | 28                                   | 2.4                                         | (2)                        | 138                          |
| - construction                                           | 457                  | 122        | 10               | 26.7                                  | 8                                    | 2.2                                         | 9                          | 17                           |
| - other                                                  | 36,212               | 392        | 821              | 1.1                                   | 209                                  | 2.3                                         | (193)                      | 166                          |
| RoW                                                      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 380                  | 33         | 12               | 8.7                                   | 36                                   | 3.2                                         | 3                          | —                            |
| - personal lending                                       | 1,507                | 1          | 1                | 0.1                                   | 100                                  | 0.1                                         | —                          | —                            |
| - property                                               | 728                  | 373        | 141              | 51.2                                  | 38                                   | 19.4                                        | (37)                       | 35                           |
| - construction                                           | 9                    | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - other                                                  | 5,901                | 213        | 136              | 3.6                                   | 64                                   | 2.3                                         | (7)                        | 6                            |
| Total third-party                                        | 445,819              | 38,978     | 18,469           | 8.7                                   | 47                                   | 4.1                                         | 6,969                      | 4,183                        |
| Amounts due from holding company and fellow subsidiaries | 792                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 446,611              | 38,978     | 18,469           | 8.7                                   | 47                                   | 4.1                                         | 6,969                      | 4,183                        |
| Banks                                                    | 59,465               | 94         | 85               | 0.3                                   | 90                                   | 0.3                                         | —                          | —                            |

## Financial review *Risk and balance sheet management*

### Sector and geographical regional analyses: Core

|                                                          | Gross loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment charge<br>£m | Amounts written-off<br>£m |
|----------------------------------------------------------|-------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|-------------------------|---------------------------|
|                                                          |                   |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                         |                           |
| 2013                                                     |                   |            |                  |                                       |                                      |                                             |                         |                           |
| Central and local government                             | 7,463             | 2          | 2                | —                                     | 100                                  | —                                           | 2                       | —                         |
| Finance                                                  | 33,832            | 375        | 182              | 1.1                                   | 49                                   | 0.5                                         | 25                      | 25                        |
| Personal - mortgages                                     | 146,600           | 5,815      | 1,731            | 4.0                                   | 30                                   | 1.2                                         | 354                     | 327                       |
| - unsecured                                              | 27,814            | 2,325      | 1,876            | 8.4                                   | 81                                   | 6.7                                         | 371                     | 810                       |
| Property                                                 | 43,169            | 5,581      | 2,473            | 12.9                                  | 44                                   | 5.7                                         | 1,346                   | 464                       |
| Construction                                             | 5,054             | 704        | 415              | 13.9                                  | 59                                   | 8.2                                         | 163                     | 96                        |
| Manufacturing                                            | 20,037            | 540        | 389              | 2.7                                   | 72                                   | 1.9                                         | 139                     | 60                        |
| Finance leases and instalment credit                     | 10,271            | 139        | 89               | 1.4                                   | 64                                   | 0.9                                         | 23                      | 31                        |
| Retail, wholesale and repairs                            | 18,656            | 807        | 521              | 4.3                                   | 65                                   | 2.8                                         | 211                     | 115                       |
| Transport and storage                                    | 13,832            | 1,049      | 432              | 7.6                                   | 41                                   | 3.1                                         | 401                     | 78                        |
| Health, education and leisure                            | 15,479            | 870        | 489              | 5.6                                   | 56                                   | 3.2                                         | 276                     | 83                        |
| Hotels and restaurants                                   | 6,232             | 810        | 474              | 13.0                                  | 59                                   | 7.6                                         | 155                     | 158                       |
| Utilities                                                | 4,027             | 63         | 44               | 1.6                                   | 70                                   | 1.1                                         | 65                      | 23                        |
| Other                                                    | 26,180            | 1,182      | 799              | 4.5                                   | 68                                   | 3.1                                         | 227                     | 158                       |
| Latent                                                   | —                 | —          | 1,380            | —                                     | —                                    | —                                           | 31                      | —                         |
| Total third-party                                        | 378,646           | 20,262     | 11,296           | 5.4                                   | 56                                   | 3.0                                         | 3,789                   | 2,428                     |
| Amounts due from holding company and fellow subsidiaries | 1,620             | —          | —                | —                                     | —                                    | —                                           | —                       | —                         |
|                                                          | 380,266           | 20,262     | 11,296           | 5.3                                   | 56                                   | 3.0                                         | 3,789                   | 2,428                     |
| of which:                                                |                   |            |                  |                                       |                                      |                                             |                         |                           |
| UK                                                       |                   |            |                  |                                       |                                      |                                             |                         |                           |
| - residential mortgages                                  | 110,515           | 1,901      | 318              | 1.7                                   | 17                                   | 0.3                                         | 37                      | 177                       |
| - personal lending                                       | 17,074            | 2,026      | 1,698            | 11.9                                  | 84                                   | 9.9                                         | 257                     | 675                       |
| - property                                               | 34,752            | 3,101      | 1,110            | 8.9                                   | 36                                   | 3.2                                         | 616                     | 403                       |
| - construction                                           | 4,036             | 590        | 330              | 14.6                                  | 56                                   | 8.2                                         | 123                     | 95                        |
| - other                                                  | 101,931           | 3,310      | 2,144            | 3.2                                   | 65                                   | 2.1                                         | 813                     | 400                       |
| Europe                                                   |                   |            |                  |                                       |                                      |                                             |                         |                           |
| - residential mortgages                                  | 17,347            | 3,135      | 1,286            | 18.1                                  | 41                                   | 7.4                                         | 196                     | 26                        |
| - personal lending                                       | 1,198             | 134        | 128              | 11.2                                  | 96                                   | 10.7                                        | 12                      | 24                        |
| - property                                               | 3,953             | 2,442      | 1,358            | 61.8                                  | 56                                   | 34.4                                        | 745                     | 53                        |
| - construction                                           | 377               | 75         | 56               | 19.9                                  | 75                                   | 14.9                                        | 14                      | —                         |
| - other                                                  | 18,144            | 2,193      | 2,146            | 12.1                                  | 98                                   | 11.8                                        | 738                     | 242                       |
| US                                                       |                   |            |                  |                                       |                                      |                                             |                         |                           |
| - residential mortgages                                  | 18,161            | 761        | 123              | 4.2                                   | 16                                   | 0.7                                         | 124                     | 122                       |
| - personal lending                                       | 8,477             | 148        | 33               | 1.7                                   | 22                                   | 0.4                                         | 85                      | 111                       |
| - property                                               | 4,058             | 38         | 5                | 0.9                                   | 13                                   | 0.1                                         | (15)                    | 8                         |
| - construction                                           | 312               | 34         | 24               | 10.9                                  | 71                                   | 7.7                                         | 26                      | 1                         |
| - other                                                  | 27,703            | 187        | 408              | 0.7                                   | 218                                  | 1.5                                         | (10)                    | 69                        |
| RoW                                                      |                   |            |                  |                                       |                                      |                                             |                         |                           |
| - residential mortgages                                  | 577               | 18         | 4                | 3.1                                   | 22                                   | 0.7                                         | (3)                     | 2                         |
| - personal lending                                       | 1,065             | 17         | 17               | 1.6                                   | 100                                  | 1.6                                         | 17                      | —                         |
| - property                                               | 406               | —          | —                | —                                     | —                                    | —                                           | —                       | —                         |
| - construction                                           | 329               | 5          | 5                | 1.5                                   | 100                                  | 1.5                                         | —                       | —                         |
| - other                                                  | 8,231             | 147        | 103              | 1.8                                   | 70                                   | 1.3                                         | 14                      | 20                        |
| Total third-party                                        | 378,646           | 20,262     | 11,296           | 5.4                                   | 56                                   | 3.0                                         | 3,789                   | 2,428                     |
| Amounts due from holding company and fellow subsidiaries | 1,620             | —          | —                | —                                     | —                                    | —                                           | —                       | —                         |
|                                                          | 380,266           | 20,262     | 11,296           | 5.3                                   | 56                                   | 3.0                                         | 3,789                   | 2,428                     |
| Banks                                                    | 39,763            | 69         | 62               | 0.2                                   | 90                                   | 0.2                                         | (15)                    | 40                        |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

|                                                          | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|----------------------------------------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                          |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2012                                                     |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government                             | 8,457                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                                                  | 38,886               | 179        | 93               | 0.5                                   | 52                                   | 0.2                                         | 9                          | 172                          |
| Personal - mortgages                                     | 146,758              | 6,227      | 1,690            | 4.2                                   | 27                                   | 1.2                                         | 786                        | 234                          |
| - unsecured                                              | 30,438               | 2,717      | 2,306            | 8.9                                   | 85                                   | 7.6                                         | 568                        | 718                          |
| Property                                                 | 43,599               | 4,671      | 1,674            | 10.7                                  | 36                                   | 3.8                                         | 750                        | 209                          |
| Construction                                             | 6,001                | 757        | 350              | 12.6                                  | 46                                   | 5.8                                         | 119                        | 53                           |
| Manufacturing                                            | 20,794               | 459        | 255              | 2.2                                   | 56                                   | 1.2                                         | 93                         | 56                           |
| Finance leases and instalment credit                     | 9,123                | 159        | 107              | 1.7                                   | 67                                   | 1.2                                         | 35                         | 41                           |
| Retail, wholesale and repairs                            | 20,532               | 776        | 427              | 3.8                                   | 55                                   | 2.1                                         | 172                        | 126                          |
| Transport and storage                                    | 14,450               | 440        | 112              | 3.0                                   | 25                                   | 0.8                                         | 72                         | 21                           |
| Health, education and leisure                            | 15,767               | 762        | 299              | 4.8                                   | 39                                   | 1.9                                         | 109                        | 64                           |
| Hotels and restaurants                                   | 6,887                | 1,042      | 473              | 15.1                                  | 45                                   | 6.9                                         | 138                        | 56                           |
| Utilities                                                | 4,949                | 10         | 5                | 0.2                                   | 50                                   | 0.1                                         | —                          | —                            |
| Other                                                    | 25,184               | 1,367      | 788              | 5.4                                   | 58                                   | 3.1                                         | 223                        | 173                          |
| Latent                                                   | —                    | —          | 1,309            | —                                     | —                                    | —                                           | (108)                      | —                            |
| Total third-party                                        | 391,825              | 19,566     | 9,888            | 5.0                                   | 51                                   | 2.5                                         | 2,966                      | 1,923                        |
| Amounts due from holding company and fellow subsidiaries | 1,852                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 393,677              | 19,566     | 9,888            | 5.0                                   | 51                                   | 2.5                                         | 2,966                      | 1,923                        |
| of which:                                                |                      |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 109,511              | 2,439      | 456              | 2.2                                   | 19                                   | 0.4                                         | 122                        | 32                           |
| - personal lending                                       | 19,636               | 2,454      | 2,133            | 12.5                                  | 87                                   | 10.9                                        | 474                        | 594                          |
| - property                                               | 35,531               | 2,777      | 897              | 7.8                                   | 32                                   | 2.5                                         | 394                        | 181                          |
| - construction                                           | 5,101                | 671        | 300              | 13.2                                  | 45                                   | 5.9                                         | 109                        | 47                           |
| - other                                                  | 108,105              | 2,652      | 1,734            | 2.5                                   | 65                                   | 1.6                                         | 495                        | 379                          |
| Europe                                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 17,446               | 3,059      | 1,124            | 17.5                                  | 37                                   | 6.4                                         | 521                        | 24                           |
| - personal lending                                       | 1,540                | 143        | 138              | 9.3                                   | 97                                   | 9.0                                         | 29                         | 11                           |
| - property                                               | 4,896                | 1,653      | 685              | 33.8                                  | 41                                   | 14.0                                        | 353                        | 1                            |
| - construction                                           | 510                  | 75         | 45               | 14.7                                  | 60                                   | 8.8                                         | 4                          | 3                            |
| - other                                                  | 21,151               | 2,254      | 1,676            | 10.7                                  | 74                                   | 7.9                                         | 379                        | 102                          |
| US                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 19,483               | 702        | 102              | 3.6                                   | 15                                   | 0.5                                         | 141                        | 176                          |
| - personal lending                                       | 8,209                | 119        | 34               | 1.4                                   | 29                                   | 0.4                                         | 65                         | 112                          |
| - property                                               | 2,847                | 112        | 13               | 3.9                                   | 12                                   | 0.5                                         | 3                          | 27                           |
| - construction                                           | 384                  | 5          | —                | 1.3                                   | —                                    | —                                           | 1                          | 3                            |
| - other                                                  | 28,177               | 247        | 429              | 0.9                                   | 174                                  | 1.5                                         | (132)                      | 80                           |
| RoW                                                      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 318                  | 27         | 8                | 8.5                                   | 30                                   | 2.5                                         | 2                          | 2                            |
| - personal lending                                       | 1,053                | 1          | 1                | 0.1                                   | 100                                  | 0.1                                         | —                          | 1                            |
| - property                                               | 325                  | 129        | 79               | 39.7                                  | 61                                   | 24.3                                        | —                          | —                            |
| - construction                                           | 6                    | 6          | 5                | 100.0                                 | 83                                   | 83.3                                        | 5                          | —                            |
| - other                                                  | 7,596                | 41         | 29               | 0.5                                   | 71                                   | 0.4                                         | 1                          | 148                          |
| Total third-party                                        | 391,825              | 19,566     | 9,888            | 5.0                                   | 51                                   | 2.5                                         | 2,966                      | 1,923                        |
| Amounts due from holding company and fellow subsidiaries | 1,852                | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 393,677              | 19,566     | 9,888            | 5.0                                   | 51                                   | 2.5                                         | 2,966                      | 1,923                        |
| Banks                                                    | 47,539               | 134        | 114              | 0.3                                   | 85                                   | 0.2                                         | 11                         | 14                           |

## Financial review *Risk and balance sheet management*

|                                                          | Group             |            |                  |                                       |                                      |                                             |                            |                              |
|----------------------------------------------------------|-------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                          | Gross loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      | Provisions<br>as a % of<br>gross loans<br>% | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|                                                          |                   |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% |                                             |                            |                              |
| 2011                                                     |                   |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government                             | 8,337             | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                                                  | 42,155            | 239        | 167              | 0.6                                   | 70                                   | 0.4                                         | (8)                        | 30                           |
| Personal - mortgages                                     | 138,321           | 4,704      | 1,182            | 3.4                                   | 25                                   | 0.9                                         | 776                        | 198                          |
| - unsecured                                              | 30,151            | 2,624      | 2,077            | 8.7                                   | 79                                   | 6.9                                         | 715                        | 935                          |
| Property                                                 | 38,310            | 3,681      | 998              | 9.6                                   | 27                                   | 2.6                                         | 470                        | 167                          |
| Construction                                             | 6,169             | 653        | 221              | 10.6                                  | 34                                   | 3.6                                         | 178                        | 143                          |
| Manufacturing                                            | 18,030            | 277        | 128              | 1.5                                   | 46                                   | 0.7                                         | 97                         | 104                          |
| Finance leases and instalment credit                     | 8,355             | 172        | 110              | 2.1                                   | 64                                   | 1.3                                         | 31                         | 68                           |
| Retail, wholesale and repairs                            | 18,175            | 586        | 279              | 3.2                                   | 48                                   | 1.5                                         | 196                        | 113                          |
| Transport and storage                                    | 15,675            | 325        | 52               | 2.1                                   | 16                                   | 0.3                                         | 47                         | 29                           |
| Health, education and leisure                            | 13,171            | 572        | 213              | 4.3                                   | 37                                   | 1.6                                         | 170                        | 55                           |
| Hotels and restaurants                                   | 7,118             | 952        | 354              | 13.4                                  | 37                                   | 5.0                                         | 209                        | 60                           |
| Utilities                                                | 4,959             | 22         | 1                | 0.4                                   | 5                                    | —                                           | —                          | —                            |
| Other                                                    | 24,327            | 1,111      | 603              | 4.6                                   | 54                                   | 2.5                                         | 529                        | 183                          |
| Latent                                                   | —                 | —          | 1,281            | —                                     | —                                    | —                                           | (218)                      | —                            |
| Total third-party                                        | 373,253           | 15,918     | 7,666            | 4.3                                   | 48                                   | 2.1                                         | 3,192                      | 2,085                        |
| Amounts due from holding company and fellow subsidiaries | 764               | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 374,017           | 15,918     | 7,666            | 4.3                                   | 48                                   | 2.0                                         | 3,192                      | 2,085                        |
| of which:                                                |                   |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                       |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 99,302            | 2,024      | 386              | 2.0                                   | 19                                   | 0.4                                         | 174                        | 24                           |
| - personal lending                                       | 19,218            | 2,347      | 1,895            | 12.2                                  | 81                                   | 9.9                                         | 657                        | 828                          |
| - property                                               | 31,142            | 2,475      | 568              | 7.9                                   | 23                                   | 1.8                                         | 379                        | 113                          |
| - construction                                           | 5,291             | 474        | 178              | 9.0                                   | 38                                   | 3.4                                         | 160                        | 138                          |
| - other                                                  | 106,245           | 2,076      | 1,280            | 2.0                                   | 62                                   | 1.2                                         | 370                        | 399                          |
| Europe                                                   |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 18,328            | 2,121      | 664              | 11.6                                  | 31                                   | 3.6                                         | 437                        | 10                           |
| - personal lending                                       | 1,921             | 140        | 122              | 7.3                                   | 87                                   | 6.4                                         | (8)                        | 22                           |
| - property                                               | 4,559             | 1,033      | 364              | 22.7                                  | 35                                   | 8.0                                         | 162                        | 11                           |
| - construction                                           | 466               | 81         | 42               | 17.4                                  | 52                                   | 9.0                                         | 18                         | (1)                          |
| - other                                                  | 14,699            | 1,767      | 1,246            | 12.0                                  | 71                                   | 8.5                                         | 679                        | 147                          |
| US                                                       |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 20,311            | 526        | 120              | 2.6                                   | 23                                   | 0.6                                         | 162                        | 164                          |
| - personal lending                                       | 7,505             | 136        | 59               | 1.8                                   | 43                                   | 0.8                                         | 66                         | 85                           |
| - property                                               | 2,407             | 111        | 24               | 4.6                                   | 22                                   | 1.0                                         | 16                         | 43                           |
| - construction                                           | 412               | 98         | 1                | 23.8                                  | 1                                    | 0.2                                         | —                          | 6                            |
| - other                                                  | 34,324            | 299        | 559              | 0.9                                   | 187                                  | 1.6                                         | 15                         | 90                           |
| RoW                                                      |                   |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 380               | 33         | 12               | 8.7                                   | 36                                   | 3.2                                         | 3                          | —                            |
| - personal lending                                       | 1,507             | 1          | 1                | 0.1                                   | 100                                  | 0.1                                         | —                          | —                            |
| - property                                               | 202               | 62         | 42               | 30.7                                  | 68                                   | 20.8                                        | (87)                       | —                            |
| - construction                                           | —                 | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - other                                                  | 5,034             | 114        | 103              | 2.3                                   | 90                                   | 2.0                                         | (11)                       | 6                            |
| Total third-party                                        | 373,253           | 15,918     | 7,666            | 4.3                                   | 48                                   | 2.1                                         | 3,192                      | 2,085                        |
| Amounts due from holding company and fellow subsidiaries | 764               | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 374,017           | 15,918     | 7,666            | 4.3                                   | 48                                   | 2.0                                         | 3,192                      | 2,085                        |
| Banks                                                    | 59,385            | 94         | 85               | 0.2                                   | 90                                   | 0.1                                         | —                          | —                            |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

### REIL and provisions continued

Sector and geographical regional analyses: Non-Core

|                                      | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                        |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|--------------------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                      |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2013                                 |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government         | 513                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                              | 1,043                | 160        | 96               | 15.3                                  | 60                                   | 9.2                                         | (12)                       | 18                           |
| Personal - mortgages                 | 1,747                | 189        | 50               | 10.8                                  | 26                                   | 2.9                                         | 53                         | 109                          |
| - unsecured                          | 338                  | 84         | 33               | 24.9                                  | 39                                   | 9.8                                         | 37                         | 45                           |
| Property                             | 19,080               | 14,663     | 10,683           | 76.9                                  | 73                                   | 56.0                                        | 3,779                      | 1,176                        |
| Construction                         | 1,256                | 626        | 357              | 49.8                                  | 57                                   | 28.4                                        | 128                        | 64                           |
| Manufacturing                        | 576                  | 160        | 140              | 27.8                                  | 88                                   | 24.3                                        | 57                         | 18                           |
| Finance leases and instalment credit | 3,232                | 124        | 101              | 3.8                                   | 81                                   | 3.1                                         | (7)                        | 90                           |
| Retail, wholesale and repairs        | 674                  | 360        | 252              | 53.4                                  | 70                                   | 37.4                                        | 59                         | 13                           |
| Transport and storage                | 2,595                | 441        | 202              | 17.0                                  | 46                                   | 7.8                                         | 83                         | 100                          |
| Health, education and leisure        | 601                  | 452        | 281              | 75.2                                  | 62                                   | 46.8                                        | 84                         | 37                           |
| Hotels and restaurants               | 704                  | 617        | 338              | 87.6                                  | 55                                   | 48.0                                        | 126                        | 36                           |
| Utilities                            | 783                  | 2          | 1                | 0.3                                   | 50                                   | 0.1                                         | (5)                        | —                            |
| Other                                | 1,476                | 917        | 544              | 62.1                                  | 59                                   | 36.9                                        | 267                        | 50                           |
| Latent                               | —                    | —          | 618              | —                                     | —                                    | —                                           | 42                         | —                            |
| Total third party                    | 34,618               | 18,795     | 13,696           | 54.3                                  | 73                                   | 39.6                                        | 4,691                      | 1,756                        |
| of which:                            |                      |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages              | —                    | —          | —                | —                                     | —                                    | —                                           | 1                          | 1                            |
| - personal lending                   | 24                   | 24         | 21               | 100.0                                 | 88                                   | 87.5                                        | 6                          | 5                            |
| - property                           | 9,480                | 6,675      | 4,066            | 70.4                                  | 61                                   | 42.9                                        | 1,395                      | 545                          |
| - construction                       | 655                  | 350        | 185              | 53.4                                  | 53                                   | 28.2                                        | 72                         | 64                           |
| - other                              | 7,543                | 1,377      | 1,057            | 18.3                                  | 77                                   | 14.0                                        | 277                        | 137                          |
| Europe                               |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages              | 7                    | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - personal lending                   | 69                   | 1          | 1                | 1.4                                   | 100                                  | 1.4                                         | 1                          | —                            |
| - property                           | 9,221                | 7,931      | 6,593            | 86.0                                  | 83                                   | 71.5                                        | 2,384                      | 606                          |
| - construction                       | 600                  | 276        | 172              | 46.0                                  | 62                                   | 28.7                                        | 58                         | —                            |
| - other                              | 4,069                | 1,728      | 1,275            | 42.5                                  | 74                                   | 31.3                                        | 303                        | 161                          |
| US                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages              | 1,740                | 189        | 50               | 10.9                                  | 26                                   | 2.9                                         | 52                         | 108                          |
| - personal lending                   | 245                  | 59         | 11               | 24.1                                  | 19                                   | 4.5                                         | 30                         | 40                           |
| - property                           | 221                  | 47         | 14               | 21.3                                  | 30                                   | 6.3                                         | 4                          | 17                           |
| - construction                       | 1                    | —          | —                | —                                     | —                                    | —                                           | (2)                        | —                            |
| - other                              | 150                  | 11         | 181              | 7.3                                   | nm                                   | 120.7                                       | 81                         | 33                           |
| RoW                                  |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - property                           | 158                  | 10         | 10               | 6.3                                   | 100                                  | 6.3                                         | (4)                        | 8                            |
| - other                              | 435                  | 117        | 60               | 26.9                                  | 51                                   | 13.8                                        | 33                         | 31                           |
| Total third party                    | 34,618               | 18,795     | 13,696           | 54.3                                  | 73                                   | 39.6                                        | 4,691                      | 1,756                        |
| Banks                                | 358                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |

## Financial review *Risk and balance sheet management*

|                                                          | Group             |            |                  |                                 |                                |                                       |                         |                           |
|----------------------------------------------------------|-------------------|------------|------------------|---------------------------------|--------------------------------|---------------------------------------|-------------------------|---------------------------|
|                                                          | Gross loans<br>£m | REIL<br>£m | Provisions<br>£m | Credit metrics                  |                                |                                       | Impairment charge<br>£m | Amounts written-off<br>£m |
|                                                          |                   |            |                  | REIL as a % of gross loans<br>% | Provisions as a % of REIL<br>% | Provisions as a % of gross loans<br>% |                         |                           |
| 2012                                                     |                   |            |                  |                                 |                                |                                       |                         |                           |
| Central and local government                             | 669               | —          | —                | —                               | —                              | —                                     | —                       | —                         |
| Finance                                                  | 2,151             | 324        | 125              | 15.1                            | 39                             | 5.8                                   | 79                      | 33                        |
| Personal - mortgages                                     | 2,452             | 271        | 89               | 11.1                            | 33                             | 3.6                                   | 157                     | 200                       |
| - unsecured                                              | 781               | 103        | 34               | 13.2                            | 33                             | 4.4                                   | 49                      | 67                        |
| Property                                                 | 28,510            | 16,508     | 8,148            | 57.9                            | 49                             | 28.6                                  | 1,482                   | 834                       |
| Construction                                             | 2,009             | 723        | 297              | 36.0                            | 41                             | 14.8                                  | (27)                    | 121                       |
| Manufacturing                                            | 1,134             | 157        | 94               | 13.8                            | 60                             | 8.3                                   | 15                      | 90                        |
| Finance leases and instalment credit                     | 4,397             | 283        | 187              | 6.4                             | 66                             | 4.3                                   | 9                       | 222                       |
| Retail, wholesale and repairs                            | 893               | 341        | 197              | 38.2                            | 58                             | 22.1                                  | 50                      | 44                        |
| Transport and storage                                    | 3,372             | 392        | 222              | 11.6                            | 57                             | 6.6                                   | 216                     | 56                        |
| Health, education and leisure                            | 918               | 425        | 221              | 46.3                            | 52                             | 24.1                                  | 35                      | 31                        |
| Hotels and restaurants                                   | 933               | 555        | 253              | 59.5                            | 46                             | 27.1                                  | 38                      | 46                        |
| Utilities                                                | 1,339             | 25         | 8                | 1.9                             | 32                             | 0.6                                   | —                       | —                         |
| Other                                                    | 2,238             | 717        | 318              | 32.0                            | 44                             | 14.2                                  | 106                     | 206                       |
| Latent                                                   | —                 | —          | 612              | —                               | —                              | —                                     | 95                      | —                         |
| Total third party                                        | 51,796            | 20,824     | 10,805           | 40.2                            | 52                             | 20.9                                  | 2,304                   | 1,950                     |
| Amounts due from holding company and fellow subsidiaries | 14                | —          | —                | —                               | —                              | —                                     | —                       | —                         |
|                                                          | 51,810            | 20,824     | 10,805           | 40.2                            | 52                             | 20.9                                  | 2,304                   | 1,950                     |
| of which:                                                |                   |            |                  |                                 |                                |                                       |                         |                           |
| UK                                                       |                   |            |                  |                                 |                                |                                       |                         |                           |
| - residential mortgages                                  | 19                | —          | —                | —                               | —                              | —                                     | —                       | —                         |
| - personal lending                                       | 55                | 23         | 19               | 41.8                            | 83                             | 34.5                                  | 5                       | 16                        |
| - property                                               | 18,173            | 7,718      | 3,038            | 42.5                            | 39                             | 16.7                                  | 566                     | 309                       |
| - construction                                           | 1,406             | 495        | 181              | 35.2                            | 37                             | 12.9                                  | (9)                     | 111                       |
| - other                                                  | 12,703            | 1,067      | 874              | 8.4                             | 82                             | 6.9                                   | 180                     | 444                       |
| Europe                                                   |                   |            |                  |                                 |                                |                                       |                         |                           |
| - residential mortgages                                  | 5                 | 1          | 1                | 20.0                            | 100                            | 20.0                                  | —                       | —                         |
| - personal lending                                       | 187               | —          | 1                | —                               | —                              | 0.5                                   | —                       | 1                         |
| - property                                               | 9,675             | 8,696      | 5,073            | 89.9                            | 58                             | 52.4                                  | 935                     | 403                       |
| - construction                                           | 599               | 225        | 115              | 37.6                            | 51                             | 19.2                                  | (17)                    | 1                         |
| - other                                                  | 3,948             | 1,977      | 1,158            | 50.1                            | 59                             | 29.3                                  | 437                     | 229                       |
| US                                                       |                   |            |                  |                                 |                                |                                       |                         |                           |
| - residential mortgages                                  | 2,428             | 270        | 88               | 11.1                            | 33                             | 3.6                                   | 157                     | 200                       |
| - personal lending                                       | 539               | 80         | 14               | 14.8                            | 18                             | 2.6                                   | 44                      | 50                        |
| - property                                               | 496               | 58         | 16               | 11.7                            | 28                             | 3.2                                   | (14)                    | 56                        |
| - construction                                           | 4                 | 3          | 1                | 75.0                            | 33                             | 25.0                                  | (1)                     | 9                         |
| - other                                                  | 782               | 69         | 168              | 8.8                             | 243                            | 21.5                                  | 25                      | 55                        |
| RoW                                                      |                   |            |                  |                                 |                                |                                       |                         |                           |
| - property                                               | 166               | 36         | 21               | 21.7                            | 58                             | 12.7                                  | (5)                     | 66                        |
| - other                                                  | 611               | 106        | 37               | 17.3                            | 35                             | 6.1                                   | 1                       | —                         |
| Total third party                                        | 51,796            | 20,824     | 10,805           | 40.2                            | 52                             | 20.9                                  | 2,304                   | 1,950                     |
| Amounts due from holding company and fellow subsidiaries | 14                | —          | —                | —                               | —                              | —                                     | —                       | —                         |
|                                                          | 51,810            | 20,824     | 10,805           | 40.2                            | 52                             | 20.9                                  | 2,304                   | 1,950                     |
| Banks                                                    | 198               | —          | —                | —                               | —                              | —                                     | —                       | —                         |

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued REIL and provisions continued

|                                                          | Gross<br>loans<br>£m | REIL<br>£m | Provisions<br>£m | Group<br>Credit metrics               |                                      |                                             | Impairment<br>charge<br>£m | Amounts<br>written-off<br>£m |
|----------------------------------------------------------|----------------------|------------|------------------|---------------------------------------|--------------------------------------|---------------------------------------------|----------------------------|------------------------------|
|                                                          |                      |            |                  | REIL<br>as a % of<br>gross loans<br>% | Provisions<br>as a %<br>of REIL<br>% | Provisions<br>as a % of<br>gross loans<br>% |                            |                              |
| 2011                                                     |                      |            |                  |                                       |                                      |                                             |                            |                              |
| Central and local government                             | 517                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| Finance                                                  | 2,915                | 193        | 71               | 6.6                                   | 37                                   | 2.4                                         | (113)                      | 20                           |
| Personal - mortgages                                     | 4,355                | 296        | 131              | 6.8                                   | 44                                   | 3.0                                         | 270                        | 318                          |
| - unsecured                                              | 1,330                | 44         | 37               | 3.3                                   | 84                                   | 2.8                                         | 34                         | 247                          |
| Property                                                 | 37,693               | 17,882     | 7,783            | 47.4                                  | 44                                   | 20.6                                        | 3,232                      | 1,004                        |
| Construction                                             | 2,512                | 1,096      | 472              | 43.6                                  | 43                                   | 18.8                                        | (39)                       | 101                          |
| Manufacturing                                            | 4,035                | 265        | 170              | 6.6                                   | 64                                   | 4.2                                         | 113                        | 75                           |
| Finance leases and instalment credit                     | 6,059                | 622        | 398              | 10.3                                  | 64                                   | 6.6                                         | 81                         | 102                          |
| Retail, wholesale and repairs                            | 2,000                | 364        | 189              | 18.2                                  | 52                                   | 9.5                                         | (21)                       | 38                           |
| Transport and storage                                    | 4,576                | 227        | 70               | 5.0                                   | 31                                   | 1.5                                         | 29                         | 14                           |
| Health, education and leisure                            | 1,371                | 476        | 219              | 34.7                                  | 46                                   | 16.0                                        | 134                        | 43                           |
| Hotels and restaurants                                   | 1,111                | 485        | 289              | 43.7                                  | 60                                   | 26.0                                        | 125                        | 71                           |
| Utilities                                                | 1,627                | 30         | 8                | 1.8                                   | 27                                   | 0.5                                         | 3                          | 3                            |
| Other                                                    | 2,465                | 1,080      | 363              | 43.8                                  | 34                                   | 14.7                                        | 208                        | 62                           |
| Latent                                                   | —                    | —          | 603              | —                                     | —                                    | —                                           | (279)                      | —                            |
| Total third-party                                        | 72,566               | 23,060     | 10,803           | 31.8                                  | 47                                   | 14.9                                        | 3,777                      | 2,098                        |
| Amounts due from holding company and fellow subsidiaries | 28                   | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 72,594               | 23,060     | 10,803           | 31.8                                  | 47                                   | 14.9                                        | 3,777                      | 2,098                        |
| of which:                                                |                      |            |                  |                                       |                                      |                                             |                            |                              |
| UK                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 1,423                | 52         | 11               | 3.7                                   | 21                                   | 0.8                                         | 6                          | 1                            |
| - personal lending                                       | 127                  | 37         | 30               | 29.1                                  | 81                                   | 23.6                                        | (12)                       | 179                          |
| - property                                               | 24,585               | 5,379      | 2,284            | 21.9                                  | 42                                   | 9.3                                         | 1,028                      | 377                          |
| - construction                                           | 1,882                | 771        | 324              | 41.0                                  | 42                                   | 17.2                                        | 30                         | 90                           |
| - other                                                  | 16,869               | 1,522      | 1,176            | 9.0                                   | 77                                   | 7.0                                         | 166                        | 259                          |
| Europe                                                   |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 6                    | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - personal lending                                       | 267                  | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - property                                               | 11,212               | 11,974     | 5,332            | 106.8                                 | 45                                   | 47.6                                        | 2,172                      | 497                          |
| - construction                                           | 576                  | 301        | 139              | 52.3                                  | 46                                   | 24.1                                        | (78)                       | —                            |
| - other                                                  | 7,052                | 2,028      | 909              | 28.8                                  | 45                                   | 12.9                                        | 318                        | 93                           |
| US                                                       |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - residential mortgages                                  | 2,926                | 244        | 120              | 8.3                                   | 49                                   | 4.1                                         | 264                        | 317                          |
| - personal lending                                       | 936                  | 7          | 7                | 0.7                                   | 100                                  | 0.7                                         | 46                         | 68                           |
| - property                                               | 1,370                | 218        | 68               | 15.9                                  | 31                                   | 5.0                                         | (18)                       | 95                           |
| - construction                                           | 45                   | 24         | 9                | 53.3                                  | 38                                   | 20.0                                        | 9                          | 11                           |
| - other                                                  | 1,888                | 93         | 262              | 4.9                                   | 282                                  | 13.9                                        | (208)                      | 76                           |
| RoW                                                      |                      |            |                  |                                       |                                      |                                             |                            |                              |
| - property                                               | 526                  | 311        | 99               | 59.1                                  | 32                                   | 18.8                                        | 50                         | 35                           |
| - construction                                           | 9                    | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
| - other                                                  | 867                  | 99         | 33               | 11.4                                  | 33                                   | 3.8                                         | 4                          | —                            |
| Total third-party                                        | 72,566               | 23,060     | 10,803           | 31.8                                  | 47                                   | 14.9                                        | 3,777                      | 2,098                        |
| Amounts due from holding company and fellow subsidiaries | 28                   | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |
|                                                          | 72,594               | 23,060     | 10,803           | 31.8                                  | 47                                   | 14.9                                        | 3,777                      | 2,098                        |
| Banks                                                    | 80                   | —          | —                | —                                     | —                                    | —                                           | —                          | —                            |

## Financial review *Risk and balance sheet management*

### Provisions and AFS reserves methodology

The Group's consumer portfolios, which consist of high volume, small value credits, have highly efficient largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery methods. Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements.

Provisions are assessed on a case by case basis by experienced specialists with input from professional valuers and accountants. The Group operates a transparent provisions governance framework, setting thresholds to trigger enhanced oversight and challenge.

Analyses of provisions are set out on page 153 to 155.

Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs and are subsequently measured at fair value with changes in fair value reported in owners' equity until disposal, at which stage the cumulative gain or loss is recognised in profit or loss. When there is objective evidence that an available-for-sale financial asset is impaired, any decline in its fair value below original cost is removed from equity and recognised in profit or loss.

The Group reviews its portfolios of available-for-sale financial assets for evidence of impairment, which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgement. The unrecognised losses on the Group's available-for-sale debt securities are concentrated in its portfolios of mortgage-backed securities. The losses reflect the widening of credit spreads as a result of the reduced market liquidity in these securities and the current uncertain macroeconomic outlook in the US and Europe. The underlying securities remain unimpaired.

Analyses of AFS debt securities and related AFS reserves are set out on page 156.

### REIL flow statement

REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked.

|                                            | UK<br>Retail<br>£m | UK<br>Corporate<br>£m | Wealth<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US Retail &<br>Commercial<br>£m | Markets<br>£m | Core<br>£m | Non-Core<br>£m | Group<br>£m |
|--------------------------------------------|--------------------|-----------------------|--------------|--------------------------------|----------------------|---------------------------------|---------------|------------|----------------|-------------|
| At 1 January 2013                          | 4,569              | 5,452                 | 248          | 358                            | 7,533                | 1,146                           | 394           | 19,700     | 20,824         | 40,524      |
| Transfers from fellow subsidiaries         | —                  | —                     | —            | —                              | —                    | —                               | —             | —          | 58             | 58          |
| Currency translation and other adjustments | —                  | 11                    | 2            | (3)                            | 134                  | (21)                            | 2             | 125        | 291            | 416         |
| Additions                                  | 1,302              | 4,825                 | 132          | 404                            | 2,479                | 282                             | 14            | 9,438      | 3,364          | 12,802      |
| Transfers                                  | (445)              | 418                   | —            | 133                            | —                    | —                               | —             | 106        | (1)            | 105         |
| Disposals and restructurings               | —                  | (54)                  | (3)          | (118)                          | —                    | —                               | —             | (175)      | (104)          | (279)       |
| Repayments                                 | (1,045)            | (3,654)               | (87)         | (90)                           | (1,403)              | (89)                            | (27)          | (6,395)    | (3,881)        | (10,276)    |
| Amounts written-off                        | (815)              | (772)                 | (15)         | (260)                          | (277)                | (284)                           | (45)          | (2,468)    | (1,756)        | (4,224)     |
| At 31 December 2013                        | 3,566              | 6,226                 | 277          | 424                            | 8,466                | 1,034                           | 338           | 20,331     | 18,795         | 39,126      |

|                                            | UK<br>Corporate<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US Retail<br>& Commercial<br>£m | Other<br>£m | Total<br>£m |
|--------------------------------------------|-----------------------|--------------------------------|----------------------|---------------------------------|-------------|-------------|
| <i>Non-Core (by donating divisions)</i>    |                       |                                |                      |                                 |             |             |
| At 1 January 2013                          | 2,622                 | 6,452                          | 11,316               | 418                             | 16          | 20,824      |
| Transfers from fellow subsidiaries         | —                     | 58                             | —                    | —                               | —           | 58          |
| Currency translation and other adjustments | 8                     | 83                             | 202                  | (2)                             | —           | 291         |
| Additions                                  | 1,327                 | 1,263                          | 692                  | 80                              | 2           | 3,364       |
| Transfers                                  | (1)                   | —                              | —                    | —                               | —           | (1)         |
| Disposals and restructurings               | (4)                   | (100)                          | —                    | —                               | —           | (104)       |
| Repayments                                 | (1,350)               | (1,681)                        | (809)                | (41)                            | —           | (3,881)     |
| Amounts written-off                        | (379)                 | (781)                          | (429)                | (165)                           | (2)         | (1,756)     |
| At 31 December 2013                        | 2,223                 | 5,294                          | 10,972               | 290                             | 16          | 18,795      |



## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

|                                               | UK<br>Retail<br>£m | UK<br>Corporate<br>£m | Wealth<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US Retail &<br>Commercial<br>£m | Markets<br>£m | Core<br>£m | Non-Core<br>£m | Group<br>£m |
|-----------------------------------------------|--------------------|-----------------------|--------------|--------------------------------|----------------------|---------------------------------|---------------|------------|----------------|-------------|
| At 1 January 2012                             | 4,087              | 3,988                 | 211          | 982                            | 5,523                | 1,007                           | 214           | 16,012     | 23,060         | 39,072      |
| Transfers from disposal groups                | 482                | 964                   | —            | —                              | —                    | —                               | —             | 1,446      | —              | 1,446       |
| Transfers from fellow subsidiaries            | —                  | —                     | —            | 253                            | —                    | —                               | 119           | 372        | 179            | 551         |
| Currency translation and other<br>adjustments | 83                 | 43                    | (1)          | (9)                            | (115)                | (47)                            | 76            | 30         | (419)          | (389)       |
| Additions                                     | 1,771              | 4,362                 | 111          | 252                            | 3,299                | 660                             | 19            | 10,474     | 5,622          | 16,096      |
| Transfers                                     | (33)               | 7                     | —            | (109)                          | —                    | —                               | —             | (135)      | 52             | (83)        |
| Disposals and restructurings                  | —                  | (133)                 | (8)          | (624)                          | —                    | —                               | (9)           | (774)      | (1,026)        | (1,800)     |
| Repayments                                    | (1,222)            | (3,265)               | (50)         | (55)                           | (1,102)              | (83)                            | (11)          | (5,788)    | (4,694)        | (10,482)    |
| Amounts written-off                           | (599)              | (514)                 | (15)         | (332)                          | (72)                 | (391)                           | (14)          | (1,937)    | (1,950)        | (3,887)     |
| At 31 December 2012                           | 4,569              | 5,452                 | 248          | 358                            | 7,533                | 1,146                           | 394           | 19,700     | 20,824         | 40,524      |

|                                            | UK<br>Corporate<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US Retail<br>& Commercial<br>£m | Other<br>£m | Total<br>£m |
|--------------------------------------------|-----------------------|--------------------------------|----------------------|---------------------------------|-------------|-------------|
| <i>Non-Core (by donating divisions)</i>    |                       |                                |                      |                                 |             |             |
| At 1 January 2012                          | 3,685                 | 7,210                          | 11,611               | 486                             | 68          | 23,060      |
| Transfers from fellow subsidiaries         | —                     | 179                            | —                    | —                               | —           | 179         |
| Currency translation and other adjustments | (57)                  | (64)                           | (229)                | (21)                            | (48)        | (419)       |
| Additions                                  | 1,542                 | 2,092                          | 1,658                | 325                             | 5           | 5,622       |
| Transfers                                  | 11                    | 41                             | —                    | —                               | —           | 52          |
| Disposals and restructurings               | (171)                 | (855)                          | —                    | —                               | —           | (1,026)     |
| Repayments                                 | (1,798)               | (1,248)                        | (1,585)              | (63)                            | —           | (4,694)     |
| Amounts written-off                        | (590)                 | (903)                          | (139)                | (309)                           | (9)         | (1,950)     |
| At 31 December 2012                        | 2,622                 | 6,452                          | 11,316               | 418                             | 16          | 20,824      |

#### REIL and PPLs summary

The table below analyses REIL between UK and overseas, based on the location of the lending office.

|                                             | 2013       |                |             | 2012       |                |             | 2011       |                |             |
|---------------------------------------------|------------|----------------|-------------|------------|----------------|-------------|------------|----------------|-------------|
|                                             | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m |
| Impaired loans                              |            |                |             |            |                |             |            |                |             |
| - UK                                        | 9,288      | 8,173          | 17,461      | 9,323      | 9,054          | 18,377      | 8,291      | 7,253          | 15,544      |
| - overseas                                  | 9,098      | 10,346         | 19,444      | 8,163      | 11,347         | 19,510      | 6,300      | 15,270         | 21,570      |
|                                             | 18,386     | 18,519         | 36,905      | 17,486     | 20,401         | 37,887      | 14,591     | 22,523         | 37,114      |
| Accruing loans past due 90 days or more     |            |                |             |            |                |             |            |                |             |
| - UK                                        | 1,709      | 253            | 1,962       | 1,758      | 248            | 2,006       | 1,192      | 508            | 1,700       |
| - overseas                                  | 236        | 23             | 259         | 456        | 175            | 631         | 229        | 29             | 258         |
|                                             | 1,945      | 276            | 2,221       | 2,214      | 423            | 2,637       | 1,421      | 537            | 1,958       |
| Total REIL                                  | 20,331     | 18,795         | 39,126      | 19,700     | 20,824         | 40,524      | 16,012     | 23,060         | 39,072      |
| REIL as a % of gross loans to customers (1) | 5.3%       | 54.3%          | 9.4%        | 5.0%       | 40.2%          | 9.0%        | 4.4%       | 31.8%          | 8.7%        |
| Provisions as a % of REIL                   | 56%        | 73%            | 64%         | 51%        | 52%            | 51%         | 49%        | 47%            | 48%         |

Note:

(1) Includes gross loans and REIL in disposal groups but excludes reverse repos and intercompany loans.

## Financial review *Risk and balance sheet management*

### Potential problem loans

Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

|                         | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------|------------|------------|------------|
| Potential problem loans | 782        | 760        | 553        |

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

### Past due analysis

The table below shows loans and advances to customers that were past due at the balance sheet date but are not considered impaired.

|                          | 2013       |                |             | 2012       |                |             | 2011       |                |             |
|--------------------------|------------|----------------|-------------|------------|----------------|-------------|------------|----------------|-------------|
|                          | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m |
| Past due 1-29 days       | 4,587      | 178            | 4,765       | 5,349      | 250            | 5,599       | 5,502      | 682            | 6,184       |
| Past due 30-59 days      | 1,212      | 48             | 1,260       | 1,062      | 55             | 1,117       | 1,472      | 161            | 1,633       |
| Past due 60-89 days      | 792        | 30             | 822         | 1,151      | 26             | 1,177       | 904        | 100            | 1,004       |
| Past due 90 days or more | 1,945      | 276            | 2,221       | 2,214      | 423            | 2,637       | 1,421      | 537            | 1,958       |
|                          | 8,536      | 532            | 9,068       | 9,776      | 754            | 10,530      | 9,299      | 1,480          | 10,779      |

### Past due analysis by sector\*

|                           |       |     |       |       |     |        |       |       |        |
|---------------------------|-------|-----|-------|-------|-----|--------|-------|-------|--------|
| Personal                  | 4,985 | 188 | 5,173 | 5,207 | 301 | 5,508  | 6,646 | 715   | 7,361  |
| Property and construction | 1,074 | 299 | 1,373 | 1,484 | 391 | 1,875  | 1,146 | 631   | 1,777  |
| Financial institution     | 366   | 2   | 368   | 91    | 10  | 101    | 40    | 6     | 46     |
| Other corporate           | 2,111 | 43  | 2,154 | 2,994 | 52  | 3,046  | 1,467 | 128   | 1,595  |
|                           | 8,536 | 532 | 9,068 | 9,776 | 754 | 10,530 | 9,299 | 1,480 | 10,779 |

### Impairment provisions flow statement

The movement in loan impairment provisions by division is shown in the table below.

|                                              | UK<br>Retail<br>£m | UK<br>Corporate<br>£m | International<br>Wealth<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US<br>R&C (1)<br>£m | Total<br>R&C (1)<br>£m | Markets<br>£m | Central<br>Items<br>£m | Total<br>Core<br>£m | Non-Core<br>£m | Group<br>£m |
|----------------------------------------------|--------------------|-----------------------|-------------------------------|--------------------------------|----------------------|---------------------|------------------------|---------------|------------------------|---------------------|----------------|-------------|
| 2013                                         |                    |                       |                               |                                |                      |                     |                        |               |                        |                     |                |             |
| At 1 January                                 | 2,629              | 2,432                 | 109                           | 336                            | 3,910                | 285                 | 9,701                  | 301           | —                      | 10,002              | 10,805         | 20,807      |
| Currency translation and other adjustments   | —                  | 8                     | —                             | (10)                           | 51                   | 31                  | 80                     | 5             | —                      | 85                  | 29             | 114         |
| Transfers from fellow subsidiaries           | —                  | —                     | —                             | —                              | —                    | —                   | —                      | —             | —                      | —                   | 33             | 33          |
| Amounts written-off                          | (815)              | (772)                 | (15)                          | (260)                          | (277)                | (284)               | (2,423)                | (45)          | —                      | (2,468)             | (1,756)        | (4,224)     |
| Recoveries of amounts previously written-off | 46                 | 15                    | —                             | 13                             | 1                    | 89                  | 164                    | 2             | —                      | 166                 | 83             | 249         |
| Charged to income statement                  | 320                | 1,188                 | 29                            | 223                            | 1,774                | 151                 | 3,685                  | 24            | 65                     | 3,774               | 4,691          | 8,465       |
| Unwind of discount (2)                       | (74)               | (38)                  | (3)                           | (4)                            | (81)                 | —                   | (200)                  | (1)           | —                      | (201)               | (189)          | (390)       |
| At 31 December                               | 2,106              | 2,833                 | 120                           | 298                            | 5,378                | 272                 | 11,007                 | 286           | 65                     | 11,358              | 13,696         | 25,054      |
| Individually assessed                        |                    |                       |                               |                                |                      |                     |                        |               |                        |                     |                |             |
| - banks                                      | —                  | —                     | —                             | 1                              | —                    | —                   | 1                      | 61            | —                      | 62                  | —              | 62          |
| - customers                                  | —                  | 1,462                 | 109                           | 189                            | 2,078                | 60                  | 3,898                  | 214           | 65                     | 4,177               | 12,512         | 16,689      |
| Collectively assessed                        | 1,929              | 1,096                 | —                             | —                              | 2,596                | 118                 | 5,739                  | —             | —                      | 5,739               | 566            | 6,305       |
| Latent                                       | 177                | 275                   | 11                            | 108                            | 704                  | 94                  | 1,369                  | 11            | —                      | 1,380               | 618            | 1,998       |
|                                              | 2,106              | 2,833                 | 120                           | 298                            | 5,378                | 272                 | 11,007                 | 286           | 65                     | 11,358              | 13,696         | 25,054      |

\*unaudited

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

|                                              | UK<br>Retail<br>£m | UK<br>Corporate<br>£m | International<br>Wealth<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US<br>R&C (1)<br>£m | Total<br>R&C (1)<br>£m | Markets<br>£m | Total<br>Core<br>£m | Non-Core<br>£m | Group<br>£m |
|----------------------------------------------|--------------------|-----------------------|-------------------------------|--------------------------------|----------------------|---------------------|------------------------|---------------|---------------------|----------------|-------------|
| <b>2012</b>                                  |                    |                       |                               |                                |                      |                     |                        |               |                     |                |             |
| At 1 January                                 | 2,344              | 1,623                 | 81                            | 329                            | 2,749                | 455                 | 7,581                  | 170           | 7,751               | 10,803         | 18,554      |
| Transfers from disposal groups               | 311                | 453                   | —                             | —                              | —                    | —                   | 764                    | —             | 764                 | —              | 764         |
| Currency translation and other adjustments   | 36                 | 72                    | —                             | (17)                           | (54)                 | 53                  | 90                     | 86            | 176                 | (351)          | (175)       |
| Transfers from fellow subsidiaries           | —                  | —                     | —                             | 222                            | —                    | —                   | 222                    | 70            | 292                 | 123            | 415         |
| Disposals                                    | —                  | —                     | —                             | —                              | —                    | —                   | —                      | —             | —                   | (1)            | (1)         |
| Amounts written-off                          | (599)              | (514)                 | (15)                          | (332)                          | (72)                 | (391)               | (1,923)                | (14)          | (1,937)             | (1,950)        | (3,887)     |
| Recoveries of amounts previously written-off | 96                 | 18                    | —                             | 7                              | 2                    | 85                  | 208                    | 1             | 209                 | 123            | 332         |
| Charge to income statement                   | 529                | 836                   | 46                            | 131                            | 1,364                | 83                  | 2,989                  | (12)          | 2,977               | 2,304          | 5,281       |
| Unwind of discount (2)                       | (88)               | (56)                  | (3)                           | (4)                            | (79)                 | —                   | (230)                  | —             | (230)               | (246)          | (476)       |
| At 31 December                               | 2,629              | 2,432                 | 109                           | 336                            | 3,910                | 285                 | 9,701                  | 301           | 10,002              | 10,805         | 20,807      |
| Individually assessed                        |                    |                       |                               |                                |                      |                     |                        |               |                     |                |             |
| - banks                                      | —                  | —                     | —                             | 7                              | —                    | —                   | 7                      | 107           | 114                 | —              | 114         |
| - customers                                  | —                  | 1,025                 | 96                            | 227                            | 1,213                | 46                  | 2,607                  | 188           | 2,795               | 9,502          | 12,297      |
| Collectively assessed                        | 2,439              | 1,110                 | —                             | —                              | 2,110                | 125                 | 5,784                  | —             | 5,784               | 691            | 6,475       |
| Latent                                       | 190                | 297                   | 13                            | 102                            | 587                  | 114                 | 1,303                  | 6             | 1,309               | 612            | 1,921       |
|                                              | 2,629              | 2,432                 | 109                           | 336                            | 3,910                | 285                 | 9,701                  | 301           | 10,002              | 10,805         | 20,807      |
| <b>2011</b>                                  |                    |                       |                               |                                |                      |                     |                        |               |                     |                |             |
| At 1 January                                 | 2,741              | 1,746                 | 66                            | 439                            | 1,633                | 509                 | 7,134                  | 215           | 7,349               | 9,421          | 16,770      |
| Transfers to disposal groups                 | (335)              | (436)                 | —                             | (2)                            | —                    | —                   | (773)                  | —             | (773)               | —              | (773)       |
| Intra-group transfers                        | —                  | 177                   | —                             | —                              | —                    | —                   | 177                    | —             | 177                 | (177)          | —           |
| Currency translation and other adjustments   | —                  | 23                    | 3                             | 2                              | (79)                 | (6)                 | (57)                   | (8)           | (65)                | (196)          | (261)       |
| Transfers from fellow subsidiaries           | —                  | —                     | —                             | —                              | —                    | —                   | —                      | 3             | 3                   | —              | 3           |
| Amounts written-off                          | (823)              | (658)                 | (11)                          | (84)                           | (124)                | (373)               | (2,073)                | (12)          | (2,085)             | (2,098)        | (4,183)     |
| Recoveries of amounts previously written-off | 69                 | 17                    | —                             | 3                              | 1                    | 76                  | 166                    | —             | 166                 | 342            | 508         |
| Charge to income statement                   | 788                | 790                   | 25                            | (16)                           | 1,384                | 249                 | 3,220                  | (28)          | 3,192               | 3,777          | 6,969       |
| Unwind of discount (2)                       | (96)               | (36)                  | (2)                           | (13)                           | (66)                 | —                   | (213)                  | —             | (213)               | (266)          | (479)       |
| At 31 December                               | 2,344              | 1,623                 | 81                            | 329                            | 2,749                | 455                 | 7,581                  | 170           | 7,751               | 10,803         | 18,554      |
| Individually assessed                        |                    |                       |                               |                                |                      |                     |                        |               |                     |                |             |
| - banks                                      | —                  | —                     | 2                             | 7                              | —                    | —                   | 9                      | 76            | 85                  | —              | 85          |
| - customers                                  | —                  | 679                   | 70                            | 207                            | 991                  | 73                  | 2,020                  | 87            | 2,107               | 9,440          | 11,547      |
| Collectively assessed                        | 2,157              | 676                   | —                             | —                              | 1,282                | 162                 | 4,277                  | —             | 4,277               | 760            | 5,037       |
| Latent                                       | 187                | 268                   | 9                             | 115                            | 476                  | 220                 | 1,275                  | 7             | 1,282               | 603            | 1,885       |
|                                              | 2,344              | 1,623                 | 81                            | 329                            | 2,749                | 455                 | 7,581                  | 170           | 7,751               | 10,803         | 18,554      |

Notes:

(1) Retail & Commercial.

(2) Recognised in interest income.

## Financial review *Risk and balance sheet management*

|                                              | UK<br>Corporate<br>£m | International<br>Banking<br>£m | Ulster<br>Bank<br>£m | US<br>R&C (1)<br>£m | Other<br>£m | Total<br>£m |
|----------------------------------------------|-----------------------|--------------------------------|----------------------|---------------------|-------------|-------------|
| <i>Non-Core (by donating divisions)</i>      |                       |                                |                      |                     |             |             |
| At 1 January 2013                            | 1,167                 | 2,499                          | 6,864                | 257                 | 18          | 10,805      |
| Currency translation and other adjustments   | (12)                  | 28                             | 56                   | (43)                | —           | 29          |
| Transfers from fellow subsidiaries           | —                     | 33                             | —                    | —                   | —           | 33          |
| Amounts written-off                          | (379)                 | (781)                          | (429)                | (165)               | (2)         | (1,756)     |
| Recoveries of amounts previously written-off | 11                    | 31                             | —                    | 41                  | —           | 83          |
| Charged to income statement                  | 355                   | 1,161                          | 3,021                | 156                 | (2)         | 4,691       |
| Unwind of discount (2)                       | (17)                  | (49)                           | (123)                | —                   | —           | (189)       |
| At 31 December 2013                          | 1,125                 | 2,922                          | 9,389                | 246                 | 14          | 13,696      |
| Individually assessed                        |                       |                                |                      |                     |             |             |
| - customers                                  | 761                   | 2,751                          | 8,981                | 19                  | —           | 12,512      |
| Collectively assessed                        | 324                   | —                              | 179                  | 48                  | 15          | 566         |
| Latent                                       | 40                    | 171                            | 229                  | 179                 | (1)         | 618         |
|                                              | 1,125                 | 2,922                          | 9,389                | 246                 | 14          | 13,696      |

|                                              |       |       |       |       |      |         |
|----------------------------------------------|-------|-------|-------|-------|------|---------|
| At 1 January 2012                            | 1,633 | 2,420 | 6,302 | 416   | 32   | 10,803  |
| Currency translation and other adjustments   | (100) | (42)  | (109) | (89)  | (11) | (351)   |
| Transfers from fellow subsidiaries           | —     | 123   | —     | —     | —    | 123     |
| Disposals                                    | —     | —     | —     | (1)   | —    | (1)     |
| Amounts written-off                          | (590) | (903) | (139) | (309) | (9)  | (1,950) |
| Recoveries of amounts previously written-off | 21    | 33    | 4     | 63    | 2    | 123     |
| Charged to income statement                  | 241   | 906   | 976   | 177   | 4    | 2,304   |
| Unwind of discount (2)                       | (38)  | (38)  | (170) | —     | —    | (246)   |
| At 31 December 2012                          | 1,167 | 2,499 | 6,864 | 257   | 18   | 10,805  |
| Individually assessed                        |       |       |       |       |      |         |
| - customers                                  | 688   | 2,311 | 6,478 | 24    | 1    | 9,502   |
| Collectively assessed                        | 422   | —     | 160   | 92    | 17   | 691     |
| Latent                                       | 57    | 188   | 226   | 141   | —    | 612     |
|                                              | 1,167 | 2,499 | 6,864 | 257   | 18   | 10,805  |

### Impairment charge analysis

The table below analyses the impairment charge for loans and securities.

|                                  | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|----------------------------------|------------|------------|------------|
| Individually assessed            | 6,952      | 3,100      | 4,896      |
| Collectively assessed            | 1,455      | 2,183      | 2,570      |
| Latent loss                      | 73         | (13)       | (497)      |
| Loans and advances to customers  | 8,480      | 5,270      | 6,969      |
| Loans and advances to banks      | (15)       | 11         | —          |
| Securities                       | (16)       | (67)       | 207        |
| Charge to income statement       | 8,449      | 5,214      | 7,176      |
| Charge as a % of gross loans (1) | 2.0%       | 1.2%       | 1.5%       |

Note:

(1) Customer loan impairment charge as a percentage of gross loans and advances to customers including assets of disposal groups and excluding reverse repurchase agreements.

## Financial review *Risk and balance sheet management*

### Balance sheet analysis continued

#### REIL and provisions continued

|                                 | 2013       |                |             | 2012       |                |             | 2011       |                |             |
|---------------------------------|------------|----------------|-------------|------------|----------------|-------------|------------|----------------|-------------|
|                                 | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m | Core<br>£m | Non-Core<br>£m | Total<br>£m |
| Loan impairment losses          |            |                |             |            |                |             |            |                |             |
| - customers                     | 3,789      | 4,691          | 8,480       | 2,966      | 2,304          | 5,270       | 3,192      | 3,777          | 6,969       |
| - banks                         | (15)       | —              | (15)        | 11         | —              | 11          | —          | —              | —           |
|                                 | 3,774      | 4,691          | 8,465       | 2,977      | 2,304          | 5,281       | 3,192      | 3,777          | 6,969       |
| Impairment losses on securities |            |                |             |            |                |             |            |                |             |
| - debt securities               | 23         | (39)           | (16)        | 15         | (112)          | (97)        | 111        | 61             | 172         |
| - equity securities             | —          | —              | —           | 13         | 17             | 30          | 4          | 31             | 35          |
|                                 | 23         | (39)           | (16)        | 28         | (95)           | (67)        | 115        | 92             | 207         |
| Charge to income statement      | 3,797      | 4,652          | 8,449       | 3,005      | 2,209          | 5,214       | 3,307      | 3,869          | 7,176       |

### AFS reserves

The table below analyses available-for-sale debt securities and related reserves, gross of tax.

|                              | 2013     |          |                 |             | 2012     |          |                 |             | 2011     |          |                 |             |
|------------------------------|----------|----------|-----------------|-------------|----------|----------|-----------------|-------------|----------|----------|-----------------|-------------|
|                              | UK<br>£m | US<br>£m | Other (1)<br>£m | Total<br>£m | UK<br>£m | US<br>£m | Other (1)<br>£m | Total<br>£m | UK<br>£m | US<br>£m | Other (1)<br>£m | Total<br>£m |
| Central and local government | 6,436    | 11,456   | 6,824           | 24,716      | 7,950    | 17,514   | 10,083          | 35,547      | 10,654   | 18,769   | 13,987          | 43,410      |
| Banks                        | 327      | 44       | 2,160           | 2,531       | 509      | 56       | 2,368           | 2,933       | 640      | 41       | 3,943           | 4,624       |
| Other financial institutions | 2,297    | 8,327    | 2,666           | 13,290      | 2,815    | 10,571   | 2,581           | 15,967      | 3,079    | 17,453   | 2,375           | 22,907      |
| Corporate                    | 21       | 71       | 53              | 145         | 29       | —        | 85              | 114         | 45       | 5        | 401             | 451         |
| Total                        | 9,081    | 19,898   | 11,703          | 40,682      | 11,303   | 28,141   | 15,117          | 54,561      | 14,418   | 36,268   | 20,706          | 71,392      |
| Of which ABS                 | 2,284    | 13,101   | 1,591           | 16,976      | 2,913    | 14,117   | 1,923           | 18,953      | 3,153    | 20,102   | 2,741           | 25,996      |
| AFS reserves (gross)         | 92       | 133      | 63              | 288         | 603      | 1,123    | 546             | 2,272       | 773      | 1,537    | 550             | 2,860       |

Note:

(1) Includes eurozone countries as detailed in the Country risk section.

|             |                        |
|-------------|------------------------|
| Market risk |                        |
| 158         | Definition             |
| 158         | Sources of risk        |
| 159         | Governance structure   |
| 160         | Traded market risk     |
| 168         | Non-traded market risk |

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## Financial review *Risk and balance sheet management*

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### Market risk

#### Definition

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

#### Sources of risk

The Group is exposed to traded market risk through its trading activities and to non-traded market risk as a result of its banking activities. In many respects, it manages its traded and non-traded market risk exposures separately, as described in this section, largely in line with the regulatory definitions of the trading and non-trading books.

#### Traded market risk

The majority of the Group's traded market risk exposure arises in Markets and Non-Core.

The primary objective of the Group's trading activities is to provide a range of financing, risk management and investment services to its customers, including major corporations and financial institutions around the world. From a market risk perspective, the Group's trading activities are included within the following markets: currencies; emerging markets; rates; asset-backed products; and traded credit.

The Group undertakes transactions in financial instruments including debt securities, loans, deposits, equities, and securities financing and derivative transactions.

Some of these transactions involve trading or clearing financial instruments on an exchange, including interest rate swaps, futures and options. Holders of exchange-traded instruments provide margin on a daily basis with cash or other security at the exchange.

Other transactions involve trading financial instruments over-the-counter rather than on an exchange. Transactions with standard terms are cleared through central counterparties, while complex transactions are cleared directly with the counterparty. These range from commoditised transactions in derivative markets to trades tailored to meet specific customer requirements. Such transactions also give rise to counterparty credit risk, which the Group manages actively (for more information on how the Group manages counterparty credit risk, see the Credit Risk section, page 69).

#### Non-traded market risk

The majority of the Group's non-traded market risk exposure arises from retail and commercial banking activities in all divisions from assets and liabilities that are not classified as held-for-trading.

Non-traded market risk largely comprises: non-traded interest rate risk (NTIRR) and non-traded foreign exchange risk, which are the most significant categories, and non-traded equity risk.

#### Interest rate risk

NTIRR arises from the provision to customers of a range of banking products that have differing interest rate characteristics. Therefore, when aggregated, these products form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market interest rates. Mismatches in these sensitivities can give rise to volatility in net interest income as interest rates rise and fall.

NTIRR comprises four primary risk factors: repricing risk, yield curve risk, basis risk and optionality risk. For more information, see pages 168 and 169.

#### Foreign exchange risk

Non-traded foreign exchange risk exposures for the Group arise from two main sources:

- the capital deployed in foreign subsidiaries, branches and associates and related currency funding where it differs from Sterling (these exposures are known as structural foreign exchange exposures); and
- customer transactions and profits and losses in a currency that differs from the functional currency of the underlying balance sheet on which activity occurs.

#### Equity risk

Non-traded equity risk is the potential variation in the income and reserves arising from changes in the values of non-trading book equity positions. Equity exposures arise through strategic acquisitions, venture capital investments and through GRG restructuring arrangements.

#### Pension risk

The RBS Group's pension-related activities also give rise to market risk. Refer to pages 188 and 189 for more information on risk related to pensions.

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## Financial review *Risk and balance sheet management*

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### Governance structure

For general information on risk governance in the RBS Group, see the Risk governance section on pages 29 to 35.

The RBS Group Chief Risk Officer (CRO) delegates responsibility for day-to-day control of market risk to the RBS Group's traded and non-traded market risk functions. Responsibility for controlling market risk in divisions is delegated to divisional market risk functions, the heads of which are accountable to divisional CROs, who in turn are accountable to the RBS Group CRO.

### Risk management

Frameworks and processes common to both traded and non-traded market risk management are described in this sub-section. Separate sub-sections on traded and non-traded market risk follow, which provide more detailed information specific to the management and measurement of these two risk types.

### Risk appetite and limit framework\*

Market risk appetite is the level of market risk that the Group accepts when pursuing its business objectives, taking into account both projected and stressed scenarios. The Group has a comprehensive structure and controls in place aimed at ensuring that this appetite is not exceeded.

The RBS Group's qualitative market risk appetite is set out in policy statements. These define the governance, responsibilities, control framework and requirements for the identification, measurement, analysis, management and reporting of market risk arising from the RBS Group's trading and non-trading activities. These policies are also cascaded, as appropriate, to the RBS Group's legal entities, divisions and businesses to ensure there is a consistent control framework throughout.

RBS Group market risk limits that express its market risk appetite in quantitative terms for trading and non-trading activities are proposed by, respectively, the heads of traded and non-traded market risk. Once approved by the Executive Risk Forum (ERF), these limits establish a set of comprehensive boundaries within which business activities are conducted and monitored. The heads of traded and non-traded market risk cascade the RBS Group market risk limits down to the legal entities and divisions. The divisional market risk functions are responsible for cascading divisional and legal entity market risk limits to lower levels as appropriate.

The limit framework comprises not only RBS Group limits but also divisional, legal entity and lower level limits and aims to capture all material market risks arising from the RBS Group's activities.

The limit framework at the RBS Group level comprises Value-at-Risk (VaR), Stressed Value-at-Risk (SVaR), sensitivity and stress limits (for more details on VaR and SVaR, see pages 161 to 164). The limit framework at the divisional, legal entity and lower levels also comprises additional metrics that are specific to the market risk exposures within its scope. These additional metrics aim to control various risk dimensions such as product type, exposure size, aged inventory, currency and tenor.

The limits are reviewed to reflect changes in risk appetite, business plans, portfolio composition and the market and economic environments.

\*unaudited

Limit breaches at the RBS Group level require escalation by the head of traded market risk or the head of non-traded market risk, as appropriate, to the ERF and the RBS Group CRO. Limit breaches at the divisional or legal entity level require escalation by the head of the relevant divisional market risk function to the head of traded market risk or the head of non-traded market risk, as appropriate.

### Valuation and independent price verification

Traders are responsible for marking-to-market their trading book positions daily, ensuring that assets and liabilities in the trading book are measured at their fair value. Any profits or losses on the revaluation of positions are recognised daily.

Business unit controllers are responsible for ensuring that independent price verification processes are in place covering all trading book positions held by their business. Independent price verification is the key control over front office marking of positions.

For more information on valuation controls, refer to page 245. The validation of pricing models is discussed below.

### Model validation

This sub-section discusses the independent model validation framework governing both pricing models and risk models (including Value-at-Risk).

The RBS Group uses a variety of models to manage and measure market risk, as described below. These models comprise pricing models (used for valuation of positions) and risk models (for risk measurement and capital calculation purposes). They are developed in both divisional units and RBS Group functions and are subject to independent review and sign-off.

The RBS Group has a dedicated independent model review and challenge function, Group Risk Analytics (GRA), which performs reviews of relevant models in two instances: (i) for new models or amendments to existing models and (ii) as part of its ongoing programme to assess the performance of these models.

A new model is typically introduced when an existing model is no longer fit for purpose or a new product requires a new methodology or model to quantify the risk appropriately. Amendments are usually made when a weakness is identified during use of a model or following analysis either by the model developers in the divisions or by GRA.

GRA also reassesses the appropriateness of approved models following significant market or regulatory developments or portfolio changes. The mechanics of the review process are the same as those for new models.

### Pricing models\*

Pricing models are developed by a dedicated front office team, in conjunction with the trading desk. They are used for the valuation of positions for which prices are not directly observable and for the risk management of the portfolio.

Any pricing models that are used as the basis for valuing books and records are subject to approval and oversight by asset-level modelled product review committees.



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## Financial review *Risk and balance sheet management*

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### Market risk *continued*

### Risk management *continued*

### Pricing models\* *continued*

These committees comprise representatives of the major stakeholders in the valuation process - trading, finance, market risk, model development and model review functions.

The review process comprises the following steps:

- The committees prioritise models for GRA review, considering the materiality of the risk booked against the model and an assessment of the degree of model risk, that is the valuation uncertainty arising from the choice of modelling assumptions.
- GRA quantifies the model risk by comparing front office model outputs with those of alternative models independently developed by GRA.
- The sensitivities derived from the pricing models are validated.
- The conclusions of the review are used by Market Risk to inform risk limits and by Finance to inform model reserves.

### Risk models\*

All new risk models are subject to GRA review and sign-off.

All model changes are approved through model governance at the divisional level. Changes to existing models that have an impact on VaR exceeding 5% at legal entity level or 15% at a major business level are also subject to GRA review and sign-off as are all model changes that require regulator approval before implementation.

The traded market risk team in Markets also performs regular VaR model testing, which is discussed in more detail under Risk Measurement - Value at Risk on page 169.

GRA's independent review comprises some or all of the following steps, as appropriate:

- Testing and challenging the logical and conceptual soundness of the methodology;
- Testing the assumptions underlying the model, where feasible, against actual behaviour. In its validation report, GRA will opine on the reasonableness and stability of the assumptions and specify which assumptions, if any, should be routinely monitored in production;
- Testing whether all key market risks have been sufficiently captured;
- Re-applying the proposed approach to verify that the same outcome is achieved;
- Comparing outputs with results from alternative methods;
- Testing parameter selection and calibration;

- Ensuring model outputs are sufficiently conservative in areas where there is significant model uncertainty;
- Confirming the applicability of tests for accuracy and stability; recalculating and ensuring that results are robust; and
- Ensuring appropriate sensitivity analysis has been performed and documented.

Based on the review and findings from GRA, an internal model governance committee with appropriate delegated authority considers whether a model can be approved for use and whether any conditions need to be imposed, including those relating to the remediation of material issues raised through the review process. Once approved through internal governance, the new or amended model is implemented. Models used for regulatory reporting may additionally require PRA approval before implementation.

GRA also reassesses the appropriateness of approved risk models annually.

### Traded market risk

#### Identification and assessment

Identification and assessment of traded market risk is achieved through gathering, analysing, monitoring and reporting market risk information by business line or at a consolidated level. Industry expertise, continued system developments and techniques such as stress testing are also used to enhance the effectiveness of the identification of all material market risks.

This is complemented by the RBS Group's New Product Risk Assessment process, which requires market risk teams to assess and quantify market risk associated with all proposed new products.

#### Reporting and monitoring

The RBS Group's traded market risk exposures are monitored against limits and analysed daily by market risk reporting and control functions. A daily report that summarises the RBS Group's market risk exposures against the limits set by the ERF is sent to the RBS Group CRO, divisional CROs and market risk managers across the divisions.

Divisional market risk functions also prepare daily risk reports that detail exposures against a more granular set of limits and triggers.

Limit reporting is supplemented with regulatory capital and stress testing information as well as ad hoc reporting.

Finally, a market risk update is included in the monthly risk management report sent to the RBS Group Board. The update covers the key risks and trends, together with a discussion of relevant issues and market topics.

#### Mitigation

To ensure approved limits are not breached and that the RBS Group remains within its risk appetite, triggers at RBS Group, legal entity and divisional levels, triggers have been set such that if exposures exceed a specified level, action plans are developed by the front office, Market Risk and Finance.

\*unaudited

## Financial review *Risk and balance sheet management*

### Counterparty Exposure Management

Management of the over-the-counter derivative counterparty credit risk and funding risk is carried out by the Counterparty Exposure Management (CEM) desk in Markets. CEM actively manages risk exposures and concentrations on behalf of both Markets and Non-Core. The hedging transactions CEM enters into are booked in the trading book and therefore contribute to the Group's market risk VaR exposure and capital.

### Risk measurement

The RBS Group uses a comprehensive and complementary set of methodologies and techniques to measure traded market risk that collectively ensure a complete approach to the measurement of material market risks.



The Group's main measurement methods are VaR and SVaR. Risks that are not adequately captured by these model methodologies are captured by the Risks Not in VaR (RNIV) framework to ensure that the RBS Group is adequately capitalised for market risk. In addition, stress testing is used to identify any vulnerabilities and potential losses in excess of VaR and SVaR.

These methods have been designed to capture correlation effects and facilitate an aggregated view of its traded market risk across risk types, markets and business lines while also taking into account the characteristics of each risk type.

Each of these methodologies and techniques is discussed in more detail below.

### Value-at-Risk

VaR is a statistical estimate of the potential change in the market value of a portfolio (and, thus, the impact on the income statement) over a specified time horizon at a given confidence level.

For internal risk management purposes, the Group's VaR assumes a time horizon of one trading day and a confidence level of 99%. The Group's VaR model is based on a historical simulation, utilising data from the previous 500 days on an equally weighted basis.

The Group's internal traded VaR model captures all trading book positions including those approved by the regulator. In 2013, improvements were made to the risk sensitivities associated with funding valuation adjustment (FVA) which resulted in a reduction in the hedge portfolio. At the point of implementation, the impact on RBS plc was a £9 million decrease in 1 day 99% regulatory VaR and an associated £42 million decrease in regulatory SVaR. The current internal VaR methodology does not include credit valuation adjustment (CVA) and FVA exposures as these are out of scope of the measure, although the Group is planning to include these in its internal VaR measure in 2014. For an explanation of the distinction between internal VaR and regulatory VaR, see page 165.

The internal VaR model captures the impact on the income statement of the following risk factors:

- Interest rate risk, which arises from the impact of changes in interest rates and volatilities on cash instruments and derivatives. This includes interest rate tenor basis risk and cross-currency basis risk.
- Credit spread risk, which arises from the impact of changes in the credit spreads of sovereign bonds, corporate bonds, securitised products and credit derivatives.
- Currency risk, which arises from the impact of changes in currency rates and volatilities.
- Equity risk, which arises from the impact of changes in equity prices, volatilities and dividend yields.
- Commodity risk, which arises from the impact of changes in commodity prices and volatilities.

The risk factors presented above are sufficient to define the Group's overall market risk exposures. In addition, the following risks, which are components of the above-mentioned risk factors, are also monitored by individual businesses to identify and address any material concentrations:

- Basis risk, which is the risk that imperfect correlation between two instruments in a hedging strategy creates the potential for excess gains or losses, thus adding risk to the position;
- Prepayment risk, which is the risk associated with early unscheduled return of principal on a fixed rate security; and
- Inflation risk, which is the risk of a decrease in the value of instruments as a result of changes in inflation rates and associated volatilities.

## Financial review *Risk and balance sheet management*

### Market risk continued

#### Traded market risk continued

##### VaR limitations\*

Historical VaR and the Group's implementation of this risk measurement methodology have a number of known limitations, as summarised below, and the disclosures should be interpreted in light of these. The Group's approach is to supplement VaR with other risk metrics that address these limitations to ensure appropriate coverage of all material market risks.

- Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a forecast of portfolio losses based on events that occurred in the past. The Group model uses the previous two years of data; this period represents a balance between model responsiveness to recent shocks and risk factor data coverage.
- The use of a 99% confidence level VaR statistic does not provide information about losses beyond this level, usually referred to as 'tail' risks. These risks are more appropriately assessed using measures such as Stressed VaR and stress testing.
- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day. This may not fully reflect market risk at times of severe illiquidity in the market when a one-day period may be insufficient to liquidate or hedge positions fully. Thus, the regulatory VaR that is used for modelled market risk capital uses a ten-day time horizon.
- When the Group uses ten-day risk factor changes in the calculation of the regulatory VaR, the ten-day periods overlap, which can introduce an autocorrelation bias in the 99% confidence level VaR statistic. The analysis performed has shown the bias to be small and acceptable for a ten-day period.
- The Group computes the VaR of trading positions at the close of business. Positions may change substantially during the course of the trading day and so intra-day price volatility and trading may not be captured by the model.
- The data used in the model are collected from global sources. For some sources, local end-of-day, rather than London end-of-day, data may be used. This timing mismatch is more material for 1-day return periods than for 10-day periods (which are used for capitalisation purposes) as the overlaps are inherently smaller across shorter periods. When deciding whether or not to use local end-of-day timing, the internal model review committee balances the principle of aligning the treatment of positions and their associated hedges against the goal of using London end-of-day timing consistently.
- Risk factors relevant to a specific portfolio may be omitted, due to a lack of reliable data, or the use of proxy risk factors, for example the RBS Group has developed the RNIV framework to address these issues.

#### 1-day 99% traded internal VaR table

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

|                     | 2013          |                  |               |               | 2012          |                  |               |               | 2011          |                  |               |               |
|---------------------|---------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|
|                     | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m |
| Interest rate       | 37.5          | 44.8             | 79.1          | 19.6          | 63.3          | 75.7             | 95.7          | 41.4          | 52.9          | 68.3             | 77.8          | 28.1          |
| Credit spread       | 59.9          | 37.3             | 86.6          | 33.1          | 69.4          | 74.4             | 94.7          | 45.0          | 82.4          | 73.7             | 150.6         | 47.6          |
| Currency            | 8.8           | 6.6              | 21.5          | 3.8           | 10.7          | 8.0              | 23.7          | 2.9           | 9.6           | 16.1             | 18.8          | 5.2           |
| Equity              | 5.8           | 4.1              | 12.8          | 3.2           | 5.9           | 3.9              | 12.3          | 1.9           | 6.7           | 7.2              | 11.1          | 3.5           |
| Commodity           | 0.9           | 0.5              | 3.8           | 0.3           | 1.7           | 1.4              | 5.2           | 0.6           | 1.0           | 2.5              | 6.0           | —             |
| Diversification (1) | (24.2)        |                  |               |               | (55.6)        |                  |               |               | (51.1)        |                  |               |               |
| Total               | 79.6          | 69.1             | 118.9         | 42.9          | 98.2          | 107.8            | 139.7         | 68.3          | 107.8         | 116.7            | 174.9         | 61.8          |

Note:

(1) The Group benefits from diversification as it reduces risk by allocating positions across various financial instrument types, currencies and markets. The extent of the diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time. The diversification factor is the sum of the VaR on individual risk types less the total portfolio VaR.

#### Key points

- The Group's period end and average interest rate VaR declined in 2013 compared with 2012. The reduction was mainly seen in Q1 2013, when the rates desk significantly de-risked its exposures and repositioned itself to manage concentrations. The volatility seen in the second half was also due to rate volatility reflecting Bank of England and European Central Bank rate announcements and a US Federal Reserve announcement regarding tapering of its quantitative easing programme.
- The Group's period-end and average credit spread VaR declined in 2013 compared with 2012. This decline was driven by an ongoing reduction in inventory as part of Group-wide efforts to reduce RWAs ahead of CRD IV implementation. Risk reduction during the first half of the year was aided by the flow business reducing the complexity of its trading operations. In the second half of the year, the VaR decrease was driven by a reduction in the asset-backed securities inventory.

\*unaudited

## Financial review *Risk and balance sheet management*

### VaR validation\*

In addition to the independent VaR model reviews carried out by GRA (discussed on page 160), a dedicated model-testing team within Market Risk works with the risk managers to:

- Test the accuracy of the valuation methods used in the VaR model on appropriately chosen test portfolios and trades.
- Apply in-house models to perform advanced internal back-testing to complement the regulatory back-testing.
- Ensure that tests capture the effect of using external data proxies where these are used.
- Identify risks not adequately captured in VaR, and ensure that such risks are addressed via the Risks not in VaR (RNIV) framework (see page 164).
- Identify any model weaknesses or scope limitations and their impact.
- Identify and give early warning of any market or portfolio weakness that may become significant.

As well as being an important market risk measurement and control tool, the VaR model is also used to determine a significant component of the market risk capital requirement (see page 167 for more information on calculation of capital requirements). Therefore, it is subject to not only ongoing internal review and validation but also regulator-prescribed back-testing.

### VaR back-testing\*

The main approach employed to assess the ongoing model performance is back-testing, which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level.

| Description                    | Back-testing exceptions |      | Model status |
|--------------------------------|-------------------------|------|--------------|
|                                | Clean                   | Hypo |              |
| The Royal Bank of Scotland plc | —                       | —    | Green        |
| National Westminster Bank Plc  | 1                       | 1    | Green        |
| RBS Securities Inc             | —                       | —    | Green        |
| RBS Financial Products Inc     | —                       | —    | Green        |

### Key points

- Statistically the Group would expect to see back-testing exceptions 1% of the time over a one-year period. From a capital requirement perspective, the PRA categorises a firm's VaR model as green, amber or red. A green model status is consistent with a satisfactory VaR model and is achieved for models that have four or fewer exceptions in a continuous 12-month period. The Group's VaR model has maintained a green status for its regulated legal entities and hence has considered that no action is required to rectify or adapt its VaR models.
- The exception at the NatWest Bank Plc level was mainly driven by a large move in inflation following an Office of National Statistics announcement in January that it would not be changing the RPI calculation.

There are two types of profit and loss (P&L) used in back-testing comparisons: Clean P&L and Hypothetical (Hypo) P&L.

The Clean P&L figure for a particular business day is the firm's actual P&L for that day in respect of the trading activities within the scope of the firm's regulatory VaR model, adjusted by stripping out:

- Fees and commissions;
- Brokerage;
- Additions to, and releases from, reserves that are not directly related to market risk; and
- Any Day 1 P&L exceeding an amount of £500,000 (per transaction).

The Hypo P&L reflects the firm's Clean P&L excluding any intra-day activities.

A portfolio is said to produce a back-testing exception when the Clean or Hypo P&L exceeds the VaR level on a given day. Such an event may be caused by a large market movement or may highlight issues such as missing risk factors or inappropriate time series. Any such issues identified are analysed and addressed through taking appropriate remediation or development action. The Group monitors both Clean and Hypo back-testing exceptions for legal entities within the Group.

Regulatory back-testing is performed and reported on a daily basis for legal entities and major business portfolios. Divisional market risk teams also perform back-testing at the lower levels as part of the internal ongoing VaR model validation.

The back-testing described above primarily applies to Markets and Non-Core models, which are approved by the regulators. However, where appropriate, back-testing is also performed for other portfolios that are not subject to regulatory approval.

### VaR back-testing\*

The table below shows regulatory back-testing exceptions for a period of 250 days for 1-day 99% traded regulatory VaR vs. Clean and Hypo P&L for the legal entities approved by the PRA.

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Market risk continued

#### Traded market risk continued

##### Stressed VaR (SVaR)\*

As with VaR, the SVaR technique produces estimates of the potential change in the market value of a portfolio, over a specified time horizon, at a given confidence level. SVaR is a VaR-based measure using historical data from a one-year period of stressed market conditions.

The risk system simulates 99% VaR on the current portfolio for each 260-day period from 1 January 2005 to the current VaR date, moving forward one day at a time. The SVaR is the worst VaR outcome of the simulated results.

This is in contrast with VaR, which is based on a rolling 500-day historical data set. For the purposes of both internal risk management and regulatory SVaR calculation, a time horizon of ten trading days is assumed with a confidence level of 99%.

##### Risks not in VaR (RNIVs)\*

The RNIV approach is used for market risks that fall within the scope of VaR and SVaR but that are insufficiently captured by the model methodology, for example due to a lack of suitable historical data. The RNIV framework has been developed to quantify these market risks and to ensure that the RBS Group holds adequate capital.

The need for an RNIV is typically identified in one of the following two circumstances: (i) as part of the New Product Risk Assessment process, when a risk manager assesses that the associated risk is not adequately captured by the VaR model; or (ii) as a result of a recommendation made by GRA or the model validation team when reviewing the VaR model.

The RNIVs provide a capital estimate of risks not captured in the VaR model and are regularly reported and discussed with senior management and the regulator. The methodology used in the RNIV calculation is internally reviewed by the model-testing team. Where appropriate, risk managers set sensitivity limits to control specific risk factors giving rise to the RNIV. RNIVs form an integral part of the Group's ongoing model and data improvement efforts to capture all market risks in scope for model approval in VaR and SVaR. Since the introduction of the RNIV framework, the RBS Group has made significant progress in transitioning RNIVs into the VaR model.

The RBS Group adopts two approaches for the quantification of RNIVs:

- A standalone VaR approach. Under this approach, two values are calculated: (i) the VaR RNIV; and (ii) the SVaR RNIV.
- A stress-scenario approach. Under this approach an assessment of ten-day extreme, but plausible, market moves is used in combination with position sensitivities to give a stress-type loss number – the stressed RNIV value.

For each legal entity covered by the PRA VaR model waiver, RNIVs above a regulatory defined threshold are aggregated to obtain the following three measures: (i) Total VaR RNIV; (ii) Total SVaR RNIV; and (iii) Total stressed RNIV. In each of these categories, potential diversification benefits between RNIVs are ignored.

##### Stress testing\*

The RBS Group undertakes daily market risk stress testing to identify vulnerabilities and potential losses in excess of or not captured in VaR. The calculated stresses measure the impact of changes in risk factors on the fair values of the RBS Group's trading and available-for-sale portfolios.

The RBS Group conducts scenario-based sensitivity analysis and historical, macroeconomic and bottom-up stress testing.

Scenario-based sensitivity analysis measures the sensitivity of the current portfolio to defined movements in market risk factors. These risk factor movements and the resulting valuation changes are typically smaller than those considered in other stress tests.

Historical stress testing is a measure that is used for internal management. Using a similar technical framework to VaR, the current portfolio is stressed using historical data since 1 January 2005. The methodology simulates the impact of the worst loss that would be incurred by historical risk factor movements over the period, assuming a holding period specific to the risk factors and the businesses. At present, a holding period of 60 business days is applied for credit risk factors (including in the case of ABS) and for the AFS portfolios that are held by Markets Treasury and generally a period of 10 business days for other risk factors. The RBS Group reviews the holding periods annually and is considering introducing greater distinction between the liquidity assumptions associated with each risk factor.

The main strength of this methodology is that it is founded on objective data and the potential loss is directly informed by real-life examples. As with all historically based methodologies, an obvious limitation is that the approach it is not forward-looking. However, this weakness is materially addressed by the other stress testing approaches that constitute the RBS stress testing framework.

Historical stress tests form part of the RBS Group market risk limit framework and their results are reported daily to senior management.

Macroeconomic stress tests are carried out periodically as part of the RBS Group wide, cross-risk capital planning process. The scenario narratives are translated into risk factor shocks using historical events and insights by economists, risk managers and the front office. Market risk stress results are combined with those for other risks into the capital plan that is presented to the RBS Group Board. The cross-risk capital planning process is conducted twice a year, in April/May and October/November, with a planning horizon of five years. The scenario narratives cover both regulatory scenarios such as the PRA Anchor and Fed Stress comprehensive capital assessment review (CCAR) and macroeconomic scenarios identified by the firm such as a Euro Break-Up and the US Fiscal Cliff.

Bottom-up stress testing begins with the analysis of a portfolio and expresses the key vulnerabilities of the portfolio in terms of plausible, so-called vulnerability scenarios under which the portfolio would suffer material losses. These scenarios can be historical, forward-looking, macroeconomic or hypothetical. Bottom-up stress testing is used for internal management information and is not subject to limits. However, relevant scenarios are reported to senior management.

\*unaudited

## Financial review *Risk and balance sheet management*

### Economic capital

A market risk economic capital framework was developed by the RBS Group in 2013 and will be introduced in its internal reporting during 2014.

The associated models calculate the market and default risk in the trading book. The results are annualised to be consistent with the other RBS Group economic capital models to permit consolidation of all risk types as part of the RBS Group-wide economic capital programme.

### Other risk measures

In addition to SVaR and stress tests, the Group uses a range of other risk measures to complement VaR. These measures often represent local (small-amplitude) risk calculations which provide valuable additional controls, often at individual desk or business unit level. They mainly include, but are not limited to, sensitivity and position-based risk measures.

Sensitivity measures refer to the changes in deal or portfolio value that result from small changes in market parameters that are subject to the Group market risk limit framework.

Position-based measures are also used and are stated in terms that relate directly to the business activity they are applied to. Examples of such measures include the aggregate open foreign exchange position or the long, short and net amount of security or currency held and aged inventory in trading books.

### Regulatory capital\*

#### Regulatory treatment

The market risks subject to capital requirements under Pillar 1 are primarily interest rate, credit spread and equity risks in the trading book and foreign exchange and commodity risks in both the trading and non-trading books. Interest rate and equity risks are split between general and specific risks. General risks represent market risks due to a move in a market as a whole, such as a main index or yield curve, while specific risks represent market risks arising from events particular to an underlying issuer.

Firms can choose from two broad methodologies to calculate their market risk capital charge: (i) the standard rules, whereby regulator-prescribed rules must be applied, and (ii) the internal model approach, where, subject to regulatory approval, a model such as VaR is used to calculate the capital charge.

The Group uses both methods, with the internal model approach being used to calculate about 87% of its capital charge.

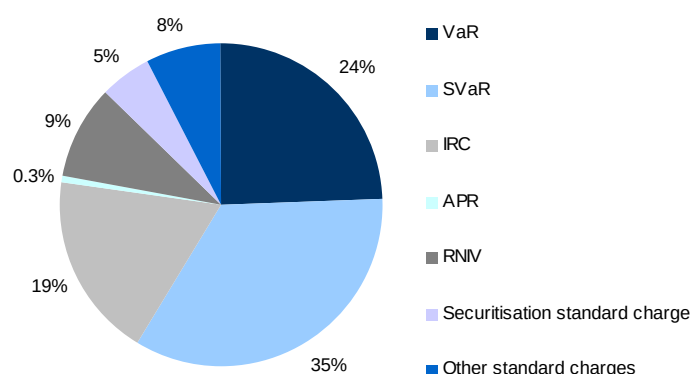
VaR and SVaR capture general and specific risks but not risks arising from the impact of defaults and rating changes associated with traded credit products and their derivatives. For these risks, three product-dependent approaches are used:

- The Incremental Risk Charge (IRC) model captures risks arising from defaults and rating changes risks for the more liquid traded credit instruments and their derivatives.

- The All Price Risk (APR) model covers the generally lower-liquidity correlation trades and their liquid hedges (such as first-to-default basket trades).
- Securitisation and re-securitisation risks in the trading book are treated with the non-trading book standardised capitalisation approach.

### RWAs by regulatory approach

The Group's market risk RWAs of £28.8 billion and minimum capital requirement of £2.3 billion are analysed below by regulatory approach.



### Regulatory VaR\*

The Group's VaR model has been approved by the PRA to calculate its regulatory market risk capital requirement for the trading book for those legal entities under its jurisdiction. These legal entities are The Royal Bank of Scotland plc, RBS Securities Inc, RBS Financial Products Inc, and National Westminster Bank Plc.

While internal VaR provides a measure of the economic risk, regulatory VaR is one of the measures of regulatory capital by legal entity.

The calculation of regulatory VaR differs from that of the internal VaR as it takes into account only regulator-approved products, locations and legal entities and it is based on a ten-day, rather than a one-day, holding period for market risk capital calculations.

The PRA approval covers general market risk in interest rate, foreign exchange, equity and commodity products and specific market risk in interest rate and equity products.

### VaR back-testing\*

For the Group's trading book, a green model status was maintained throughout 2013. For details of back-testing results for regulatory VaR, refer to the table on page 163.

\*unaudited



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## Financial review *Risk and balance sheet management*

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### Market risk continued

#### Traded market risk continued

##### Regulatory SVaR\*

The Group's SVaR model has also been approved by the PRA for use in the capital requirement calculation. The regulatory SVaR differs from internal SVaR as it covers only regulator-approved products, locations and legal entities.

##### Risks not in VaR (RNIV)\*

As discussed earlier, the Group has an established RNIV framework that ensures that the risks not captured in VaR are adequately covered by its capital.

The RNIV framework does not include tail event risks; these risks are covered indirectly by the regulatory multiplier applied to VaR and directly by relevant charges, e.g. IRC, APR and gap risk discussed below.

##### Gap risk\*

Certain traded products are structured with buffers so that losses below a certain level are borne by the Group's counterparties. These products may, however, exhibit large sudden market movements in excess of their buffer, which may result in losses for the Group. The VaR model does not fully capture the risk to the Group presented by these products. The gap risk model takes into account the liquidity of the products and the likely effectiveness of the buffer and produces an additional capital requirement for the relevant products.

This risk is concentrated in the equities business in Markets. Markets' exposure to gap risk was not material in 2013 as the portfolios considered under this framework have been significantly reduced.

##### Incremental risk charge (IRC)\*

The IRC model aims to quantify the impact of defaults and rating changes on the market value of bonds, credit derivatives and other related positions held in the trading book. It also captures basis risks between different instruments, different product maturities and different but related reference entities. Like the internal ratings-based approach for credit risk, it is calculated over a one-year holding period at a 99.9% confidence level.

The multivariate behaviour of positions is modelled via the relevant reference entities using a single-factor model (Gaussian Copula), which allows a more efficient calculation of the charge using numerical integration.

The model is mainly driven by three-month transition, default and correlation parameters. The portfolio impact of correlated defaults and rating changes is assessed with reference to the resulting change in the market value of positions, which is determined using stressed recovery rates and modelled credit spread changes. Individual instrument revaluation vectors are used to capture non-linear behaviour.

The model has different parameters for sovereign and corporate exposures. The model reflects the overall liquidity of each position referencing an entity, arising from product type, product maturity and product concentration characteristics.

A constant level of risk is assumed and achieved by replacing positions that default or migrate in one period with equivalent positions. The average liquidity horizon at the year-end for RBS plc was 3.2 months.

##### All price risk (APR)\*

The APR model determines the capital that should be held against all material price risks, including those arising from defaults and credit rating changes affecting securities in the hedged portfolio, using a 99.9% confidence level over a one-year time horizon.

This model is applied to the correlation trading portfolio subject to certain eligibility criteria (principally that the underlying names be liquid corporate CDS positions).

The most significant risks are credit spread risk, credit (base) correlation risk, index basis risk, default risk and recovery rate risk. In addition, losses due to both hedging costs and hedge slippage are modelled. The overall APR capital charge is floored at 8% of the corresponding standard rules charge for the same portfolio.

\*unaudited

## Financial review *Risk and balance sheet management*

### Market risk capital\*

#### Minimum capital requirements

The following table analyses the market risk minimum capital requirement, calculated in accordance with Basel 2.5.

|                                                         | 2013<br>£m | 2012<br>£m |
|---------------------------------------------------------|------------|------------|
| Interest rate position risk requirement                 | 122        | 224        |
| Equity position risk requirement                        | 1          | 1          |
| Option position risk requirement                        | 1          | 9          |
| Commodity position risk requirement                     | 13         | 2          |
| Foreign currency position risk requirement              | 37         | 10         |
| Specific interest rate risk of securitisation positions | 123        | 156        |
| Total (standard method)                                 | 297        | 402        |
| Pillar 1 model based position risk requirement          | 2,009      | 2,739      |
| Total market risk minimum capital requirement           | 2,306      | 3,141      |

The following table analyses the principal contributors to the Pillar 1 model based position risk requirement presented in the previous table.

|                               | 2013              |                   |                   |                  | 2012<br>£m |
|-------------------------------|-------------------|-------------------|-------------------|------------------|------------|
|                               | Average (1)<br>£m | Maximum (1)<br>£m | Minimum (1)<br>£m | Period end<br>£m |            |
| Value-at-risk (VaR) (1)       | 723               | 847               | 550               | 563              | 793        |
| Stressed VaR (SVaR)           | 988               | 1,176             | 773               | 789              | 1,115      |
| Incremental risk charge (IRC) | 349               | 431               | 249               | 431              | 390        |
| All price risk (APR)          | 11                | 13                | 8                 | 8                | 12         |
| Risk not in VaR (RNIV)        | 286               | 366               | 206               | 218              | 429        |

#### Notes:

(1) The average, maximum and minimum positions are based on the monthly Pillar 1 model based capital requirements.

(2) All items are expressed in capital requirement terms.

### Key points

- The Group's total market risk minimum capital requirement fell in 2013, largely driven by the Pillar 1 model-based contributors (primarily VaR, SVaR and RNIV). The standard method requirement also fell, driven by the interest rate position risk requirement and the specific interest rate risk of securitisation positions.
- The interest rate position risk requirement decreased, primarily due to the migration to VaR of certain trades, the maturity or closing of other trades and a reduction in unmatched positions.
- The option position risk requirement fell, driven by an increased impact of netting for some types of options. This was partially offset by the inclusion of some emerging market trades in the calculation as part of the migration of portfolios from RBS NV to RBS plc.
- The foreign currency position risk requirement increased, reflecting accelerated impairments on euro denominated assets in RBS Capital Resolution (RCR).
- Specific interest rate risk of securitisation positions: This charge decreased due to the disposal of assets, primarily in the AAA and BB rating categories, during the year.
- The decline in the VaR and SVaR based charges was driven by significant de-risking of rates exposure in RBS plc in the first half of the year. In addition, the improved capture of valuation adjustments in CEM accompanied by market data improvements drove a further reduction in these charges, particularly during the second half of the year.
- The IRC contribution to the Pillar 1 model based position risk requirement was broadly unchanged.
- The decrease in the APR charge was due to the maturing of trades, with significant reductions in the final quarter.
- The decrease in the RNIV charge was driven by progress in obtaining reliable sources of equity market data, an improvement in the VaR model for asset-backed products and a reduction in RBSSI's asset-backed product exposures.

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## Financial review *Risk and balance sheet management*

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### Market risk continued

#### Non-traded market risk

##### Risk management

Non-traded market risk positions are reported on a regular basis to divisional Asset and Liability Management Committees (ALCOs) and monthly to the RBS Group Balance Sheet Management Committee (BSMCo), the RBS Group Asset and Liability Committee (GALCO) and the RBS Group Board, with the exception of equity positions, which are reported quarterly to GALCO.

##### Interest rate risk

Non-traded interest rate risk (NTIRR) factors are grouped into the following categories:

- Repricing risk, which arises when asset and liability positions either mature (in the case of fixed-rate positions) or their interest rates reset (in the case of floating-rate positions) at different dates. These mismatches may give rise to net interest income and economic value volatility as interest rates vary.
- Yield curve risk, which arises from unanticipated changes in the shape of the yield curve, such that rates at different maturity points may move differently. Such movements may give rise to interest income and economic value volatility.
- The two risk factors above incorporate the duration risk arising from the reinvestment of maturing swaps hedging the RBS Group's net free reserves (or net exposure to equity and other low fixed-rate or non-interest-bearing liability balances including, but not limited to, current accounts).
- Basis risk, which arises when related instruments with the same tenor are valued using different reference yield curves. Changes in the spread between the different reference curves can result in unexpected changes in the valuation of or income difference between assets, liabilities or derivative instruments. This occurs, for example, in the Group's retail and commercial portfolios, when products valued on the basis of the Bank of England base rate are funded with LIBOR-linked instruments.
- Optionality risk, which arises when customers have the right to terminate, prepay or otherwise alter a transaction without penalty, resulting in a change in the timing or magnitude of the cashflows of an asset, liability or off-balance sheet instrument. This risk primarily arises in the US mortgage business in Citizens Financial Group where long-term fixed-rate loans are the norm and prepayment penalties are rare.

Due to the long-term nature of many non-trading book portfolios and their varied interest rate repricing characteristics and maturities, it is likely that net interest income will vary from period to period, even if interest rates remain the same. New business originated in any period will alter the interest rate sensitivity of the RBS Group if the resulting portfolio differs from portfolios originated in prior periods, depending on the extent to which exposure has been hedged.

The RBS Group's policy is to manage the interest rate sensitivity within risk limits that are approved by the ERF and endorsed by GALCO before being cascaded to divisions through divisional ALCOs. These include, in particular, interest rate sensitivity and VaR limits.

In order to manage exposures within these limits, the Group aggregates its interest rate positions and hedges them externally using cash and derivatives - primarily interest rate swaps.

This task is primarily carried out by RBS Group Treasury, to which all divisions except US Retail & Commercial and Markets transfer most of their NTIRR. On a monthly basis, the RBS Group's main exposures and limit utilisations are reported to the BSMCo, GALCO and the RBS Group Board.

##### Foreign exchange risk

The RBS Group's only material non-traded open currency positions are the structural foreign exchange exposures arising from its investments in foreign subsidiaries and associates and their related currency funding. These exposures are assessed and managed by RBS Group Treasury under delegated authority from GALCO. RBS Group Treasury seeks to limit the potential volatility impact on the Group's Core Tier 1 ratio from exchange rate movements to pre-defined risk appetite levels set by GALCO. The sensitivity of the RBS Group's Core Tier 1 capital to exchange rates is updated and reported to GALCO quarterly.

Foreign exchange exposures arising from customer transactions or profit and losses are sold down by divisions and businesses on a regular basis in line with RBS Group policy.

##### Risk measurement

###### Interest rate risk

NTIRR can be measured from either an economic value-based or earnings-based perspective (or both). Value-based approaches measure the change in value of the balance sheet assets and liabilities over a longer timeframe, including all cashflows. Earnings-based approaches measure the potential short-term (generally one-year) impact on the income statement of changes in interest rates.

The RBS Group uses both approaches to quantify its interest rate risk: VaR as its value-based approach and sensitivity of net interest income (NII) as its earnings-based approach.

## Financial review Risk and balance sheet management

These two approaches provide different yet complementary views of the impact of interest rate risk on the balance sheet at a point in time. The scenarios employed in the NII sensitivity approach incorporate business assumptions and simulated modifications in customer behaviour as interest rates change. In contrast, the VaR approach assumes static underlying positions and therefore does not provide a dynamic measurement of interest rate risk. In addition, while the NII sensitivity calculations are measured to a 12-month horizon and thus provide a shorter-term view of the risks on the balance sheet, the VaR approach can identify risks not captured in the sensitivity analysis, in particular the impact of duration and repricing risk on earnings beyond 12 months.

NII sensitivity is calculated and monitored at RBS Group level.

### Value-at-risk

The Group's standard VaR metrics - which assume a time horizon of one trading day and a confidence level of 99% - are based on interest rate repricing gaps at the reporting date. Daily rate moves are modelled using observations over the last 500 business days. These incorporate customer products plus associated funding and hedging transactions as well as non-financial assets and liabilities such as property, plant and equipment, capital and reserves. Behavioural assumptions are applied as appropriate.

The table below shows the NTIRR VaR for the Group's retail and commercial banking activities at a 99% confidence level together with a currency analysis of period end VaR.

|           | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m |
|-----------|---------------|------------------|---------------|---------------|
| 2013      | 100           | 108              | 130           | 73            |
| 2012      | 132           | 59               | 183           | 59            |
| 2011      | 156           | 153              | 177           | 109           |
|           |               | 2013<br>£m       | 2012<br>£m    | 2011<br>£m    |
| Euro      |               | 4                | 24            | 31            |
| Sterling  |               | 27               | 33            | 58            |
| US dollar |               | 114              | 67            | 162           |
| Other     |               | 2                | 1             | 3             |

### Key points

- The year-on-year increase in period-end VaR mainly reflected an increase in the duration of the Group's balance sheet - that is, greater economic exposure to longer-term interest rates - as described in more detail below.
- Euro VaR fell, reflecting action taken to reduce the Group's exposure to euro-denominated fixed-rate assets.
- US dollar VaR rose, reflecting action taken by US Retail & Commercial to reduce earnings sensitivity to movements in short term dollar interest rates.
- The average VaR for the Group at £100 million was higher than that for the RBS Group. This is largely because economic hedging of certain interest rate risk in different legal entities is achieved at RBS Group level only.

## Financial review *Risk and balance sheet management*

### Market risk continued

#### Currency risk

##### Structural foreign currency exposures

The Group does not maintain material non-traded open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding.

The table below shows the Group's structural foreign currency exposures.

|                    | Net investments<br>in foreign<br>operations<br>£m | Net<br>investment<br>hedges<br>£m | Structural foreign<br>currency exposures<br>pre-economic hedges<br>£m |
|--------------------|---------------------------------------------------|-----------------------------------|-----------------------------------------------------------------------|
| <b>2013</b>        |                                                   |                                   |                                                                       |
| US dollar          | 15,079                                            | (765)                             | 14,314                                                                |
| Euro               | 4,280                                             | (194)                             | 4,086                                                                 |
| Swiss franc        | 1,068                                             | (969)                             | 99                                                                    |
| Other non-sterling | 1,483                                             | (1,015)                           | 468                                                                   |
|                    | <b>21,910</b>                                     | <b>(2,943)</b>                    | <b>18,967</b>                                                         |
| <b>2012</b>        |                                                   |                                   |                                                                       |
| US dollar          | 16,194                                            | (1,386)                           | 14,808                                                                |
| Euro               | 7,271                                             | (199)                             | 7,072                                                                 |
| Swiss franc        | 1,122                                             | (1,045)                           | 77                                                                    |
| Other non-sterling | 1,439                                             | (1,011)                           | 428                                                                   |
|                    | <b>26,026</b>                                     | <b>(3,641)</b>                    | <b>22,385</b>                                                         |
| <b>2011</b>        |                                                   |                                   |                                                                       |
| US dollar          | 16,454                                            | (1,218)                           | 15,236                                                                |
| Euro               | 6,069                                             | (266)                             | 5,803                                                                 |
| Swiss franc        | 1,108                                             | (1,108)                           | —                                                                     |
| Other non-sterling | 1,049                                             | (880)                             | 169                                                                   |
|                    | <b>24,680</b>                                     | <b>(3,472)</b>                    | <b>21,208</b>                                                         |

#### Key points

- The Group's structural foreign currency exposure at 31 December 2013 was £19.0 billion, a decrease of £3.4 billion from the end of 2012, due to increased impairments in Ulster Bank Group and capital restructuring in US Retail & Commercial.
- Changes in foreign currency exchange rates will affect equity in proportion to structural foreign currency exposure. A 5% strengthening in foreign currencies against sterling would result in a gain of £1.0 billion (2012 - £1.2 billion; 2011 - £1.1 billion) in equity, while a 5% weakening would result in a loss of £0.9 billion (2012 - £1.1 billion; 2011 - £1.0 billion) in equity.

## Financial review *Risk and balance sheet management*

### Non-traded market risk

#### VaR for selected AFS non-trading portfolios

Available-for-sale portfolios in Markets and Non-Core, other than the structured credit portfolio, do not typically form part of the structural interest rate framework due to the short-term nature of the interest rate risks they carry. They are thus monitored and managed through the same framework and using the same metrics as portfolios in the trading book.

The table below details VaR for these portfolios.

|                     | 2013          |                  |               |               | 2012          |                  |               |               | 2011          |                  |               |               |
|---------------------|---------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|---------------|------------------|---------------|---------------|
|                     | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m | Average<br>£m | Period end<br>£m | Maximum<br>£m | Minimum<br>£m |
| Interest rate       | 1.9           | 0.9              | 4.7           | 0.8           | 6.3           | 4.6              | 9.1           | 4.1           | 6.3           | 9.0              | 9.1           | 4.2           |
| Credit spread       | 5.2           | 2.3              | 9.1           | 2.3           | 9.8           | 8.7              | 12.5          | 6.7           | 14.4          | 11.2             | 26.1          | 8.4           |
| Currency            | 0.5           | 0.3              | 2.6           | 0.1           | 2.3           | 0.4              | 4.0           | 0.2           | 2.0           | 3.9              | 5.5           | —             |
| Equity              | —             | —                | —             | —             | —             | —                | 0.1           | —             | —             | 0.1              | 0.2           | —             |
| Diversification (1) | (1.1)         |                  |               |               | (4.3)         |                  |               |               | (12.4)        |                  |               |               |
| Total               | 5.3           | 2.4              | 9.4           | 2.4           | 9.6           | 9.4              | 12.1          | 7.8           | 14.8          | 11.8             | 26.4          | 9.3           |

#### Notes:

- (1) The Group benefits from diversification as it reduces risk by allocating positions across various financial instrument types, currencies and markets. The extent of the diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time.
- (2) The table above excludes the structured credit portfolio and loans and receivables.

### Key point

- The Group's average and period end total and credit spread VaR declined in 2013 compared with 2012. The reduction in VaR was driven by a Group-wide effort to reduce RWAs, which entailed a change in portfolio composition as corporate positions were replaced with sovereigns and a reduction in the average duration across the portfolio. In addition, the more volatile 2011 data dropped out of the time series window.

## Financial review *Risk and balance sheet management*

### Market risk continued

#### Non-traded market risk continued

##### Structured credit portfolio

The structured credit portfolio is within Non-Core. The risk in this portfolio is not disclosed using VaR, as the Group believes this is not an appropriate tool for the banking book portfolio, which comprises illiquid debt securities. These assets are reported on a drawn notional and fair value basis, and managed on a third party asset and risk-weighted assets basis. The table below shows the open market risk in the structured credit portfolio.

|            | Drawn notional |          |         |               |       | Fair value |          |         |               |       |
|------------|----------------|----------|---------|---------------|-------|------------|----------|---------|---------------|-------|
|            | CDOs (1)       | CLOs (2) | MBS (3) | Other ABS (4) | Total | CDOs (1)   | CLOs (2) | MBS (3) | Other ABS (4) | Total |
| 2013       | £m             | £m       | £m      | £m            | £m    | £m         | £m       | £m      | £m            | £m    |
| 1-2 years  | —              | —        | —       | 4             | 4     | —          | —        | —       | 4             | 4     |
| 3-4 years  | —              | —        | —       | —             | —     | —          | —        | —       | —             | —     |
| 4-5 years  | —              | —        | —       | —             | —     | —          | —        | —       | —             | —     |
| 5-10 years | —              | 271      | —       | 91            | 362   | —          | 263      | —       | 68            | 331   |
| >10 years  | 149            | —        | 46      | 103           | 298   | 51         | —        | 24      | 70            | 145   |
|            | 149            | 271      | 46      | 198           | 664   | 51         | 263      | 24      | 142           | 480   |
| 2012       |                |          |         |               |       |            |          |         |               |       |
| 1-2 years  | —              | —        | —       | 80            | 80    | —          | —        | —       | 74            | 74    |
| 2-3 years  | —              | —        | 27      | 82            | 109   | —          | —        | 24      | 76            | 100   |
| 4-5 years  | —              | —        | 95      | —             | 95    | —          | —        | 86      | —             | 86    |
| 5-10 years | —              | 310      | 92      | —             | 402   | —          | 295      | 44      | —             | 339   |
| >10 years  | 289            | 279      | 380     | 398           | 1,346 | 116        | 256      | 253     | 254           | 879   |
|            | 289            | 589      | 594     | 560           | 2,032 | 116        | 551      | 407     | 404           | 1,478 |
| 2011       |                |          |         |               |       |            |          |         |               |       |
| 1-2 years  | —              | —        | —       | 27            | 27    | —          | —        | —       | 22            | 22    |
| 2-3 years  | —              | —        | 10      | 196           | 206   | —          | —        | 9       | 182           | 191   |
| 4-5 years  | —              | 37       | 37      | 95            | 169   | —          | 34       | 30      | 88            | 152   |
| 5-10 years | 32             | 503      | 270     | 268           | 1,073 | 30         | 455      | 184     | 229           | 898   |
| >10 years  | 2,180          | 442      | 464     | 593           | 3,679 | 766        | 371      | 291     | 347           | 1,775 |
|            | 2,212          | 982      | 781     | 1,179         | 5,154 | 796        | 860      | 514     | 868           | 3,038 |

#### Notes:

- (1) Collateralised debt obligations.
- (2) Collateralised loan obligations.
- (3) Mortgage-backed securities.
- (4) Asset-backed securities.

### Key point

- The total notional and fair value both decreased 67%, to £664 million and £480 million respectively. This was driven by the sale of underlying assets across all categories, in line with Non-Core strategy.

### Regulatory capital

The RBS Group holds capital for two types of non-traded market risk exposures: NTIRR and non-trading book foreign exchange.

Capital for the RBS Group's NTIRR is captured under the Pillar 2A process. This is calculated by considering the potential impact on the economic value of the RBS Group over a one-year horizon. The four main sources of NTIRR, repricing, yield curve, basis and optionality risks, are captured in the calculation. NTIRR capital requirements are allocated to the RBS Group's legal entities on the basis of their relative contribution to the consolidated exposure.

Pillar 1 capital must be held for non-trading book foreign exchange exposures, as outlined under BIPRU 7.5.3. The RBS Group does not hold capital for its structural foreign exchange exposures as these are excluded from the calculations as outlined under BIPRU 7.5.4.

The RBS Group's non-traded equity risk is captured in credit risk RWAs.

The RBS Group's capital calculations under ICAAP are also used for economic capital purposes.

|                     |                      |
|---------------------|----------------------|
| <b>Country risk</b> |                      |
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## Financial review *Risk and balance sheet management*

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### Country risk

#### Definition

Country risk is the risk of losses occurring as a result of either a country event or unfavourable country operating conditions. As country events may simultaneously affect all or many individual exposures to a country, country event risk is a concentration risk. For other types of concentration risks such as product, sector or single name concentration, refer to the Credit risk section.

#### External environment\*

Macroeconomic conditions stabilised in 2013 with signs of improvement in most mature economies. The US showed the strongest improvement, with private investment picking up, the housing sector continuing to strengthen, and unemployment falling. This led the Federal Reserve to announce in May plans to begin normalising monetary policy. In December it announced it would start reducing quantitative easing. This resulted in some volatility in higher-yield asset markets, particularly emerging markets, where those with the largest external financing needs saw capital outflows, currency depreciation and stock market losses.

In the second half of the year, investor concerns were heightened by the risk that the US federal debt ceiling increase would not be passed on time and that the government might delay debt payments. Short-term political solutions to these issues were found, though with further progress needed in 2014.

The eurozone region as a whole remained in recession throughout the year, but signs of recovery were evident by the second half of the year. Germany led, but the periphery also showed notable signs of stabilisation, with Ireland, Spain and Portugal all growing in quarter-on-quarter terms in the last quarter of 2013. Eurozone monetary policy support underpinned investor confidence, while progress was made in developing a banking union that should reduce the risk of a repeat of the financial crisis over the longer term. Nevertheless, France and Italy underperformed peers.

In Japan, an economic reform strategy combined with large monetary stimulus contributed to currency depreciation, a reduction in deflationary expectations and strong growth in the first half of the year. However, momentum slowed in the second half of the year.

Many emerging market economies entered 2013 with high growth rates. While most were in substantially better shape than in previous crises, some had built up significant imbalances during years of strong capital inflows. As economic conditions in mature markets, particularly the US, improved in the course of the year, markets began to anticipate that monetary policies would normalise.

This led to a sharp round of capital outflows, particularly from equity markets, in the second quarter of 2013. Currency depreciations in a number of large emerging economies followed, especially in those with significant current account deficits. Among the better rated economies, India, Brazil, Indonesia, South Africa and Turkey, were particularly affected.

To stem the outflow of foreign capital and limit the impact on domestic asset markets, some countries, including India, started tightening monetary policy and accelerated financial sector reforms. Some countries with sizeable accumulated reserve assets, including China and Russia, were able to use their reserves to ease the pressure on their currencies.

#### Outlook

Further strengthening of economic growth in advanced economies is likely in 2014, but uncertainty over the impact of “tapering” is likely to contribute to further volatility in asset prices across most regions. The US is expected to perform quite strongly, with the eurozone also likely to continue its uneven recovery, although in both cases key areas of the economy will remain fragile. A more challenging year for emerging economies is expected as net capital inflows decline, resulting in more pronounced market volatility and differentiation. Further policy tightening is likely and growth rates are set to slow, especially in the weakest markets.

#### Sources of risk

Country risk has the potential to affect all parts of the Group's portfolio across wholesale and retail activities that are directly or indirectly linked to the country in question.

It arises from possible economic or political events in each country to which the Group has exposure, and from unfavourable conditions affecting daily operations in a country.

Country events may include a sovereign default, political conflict, banking crisis or deep and prolonged recession leading to possible counterparty defaults. Transfer or convertibility restrictions imposed by a country's government to stem the loss of foreign currency reserves may temporarily prevent counterparties from meeting their payment obligations. Major currency depreciation may also affect a customer's income or debt burden, leading to default.

Unfavourable operating conditions may include the risk that a weak or creditor unfriendly legal system within a country makes it difficult for the Group to recover its claims in the event of customer default. An unreliable or unstable political system may lead to sudden compliance or reputational issues for the Group, or even expropriation without proper compensation.

#### Governance\*

The RBS Group's country risk framework is set by the RBS Group Executive Risk Forum (ERF). This body delegates authority to the RBS Group Country Risk Committee (GCRC) to decide on country risk matters, including risk appetite, risk management strategy and framework, risk exposure and policy, as well as sovereign ratings, sovereign loss given default rates and country Watchlist colours. The GCRC, which is chaired by the Head of Global Country Risk (GCoR) and includes representatives of divisions with country risk exposures, can escalate issues when necessary to the ERF.

For further information on governance, refer to the Risk governance section on page 29.

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Risk management\*

#### Risk appetite setting

RBS Group country risk appetite was re-set for all countries based on the enhanced country risk appetite framework, introduced in late 2012. This framework has “top-down” and “bottom-up” components.

The “top-down” component is guided by the RBS Group’s global risk appetite; each country’s internal sovereign rating and its strategic importance to the RBS Group; the composition of the RBS Group’s portfolio, as defined by tenors and clients; the funding profile and an assessment of the potential for losses arising from possible key country risk events. This component provides a clear structure for the consideration of downside scenarios, the identification of countries that pose material concentration risks to the Group, as well as possible management actions.

“Bottom-up” analysis includes risk/return performance together with reputational and regulatory risk.

Countries Watchlisted Amber (refer to Risk monitoring, reporting and control below) are monitored closely. Appetite for countries Watchlisted Red is limited to short-term business in areas such as trade finance and derivatives, unless the country is deemed a strategic priority country.

The actual country limits and medium-term sub-limits, with allocations to each division, are set by the GCRC (or the ERF above certain benchmark levels). The divisions manage their exposures within their country limit allocations. Divisions may agree re-allocations between themselves, and may further assign sub-allocations to business units or product groups in the division.

RBS Group country limits are set for almost all countries. The UK (and related European special territories of Guernsey, Jersey, the Isle of Man and Gibraltar) is an exception, given its home country status. The US is the other exception because of the specific local risk management structure, the size of the local portfolio and corresponding role in RBS Group-wide risk management, together with the country’s strong ratings.

#### Risk monitoring, reporting and control

GCoR monitors and reports on RBS Group-level exposures to all countries, and follows up with the divisions in the event of RBS Group-level or divisional limit excesses. GCoR has delegated authority up to specified levels to decide on country limit increases and any such decision must be reported to the GCRC. Persistent excesses are escalated to the GCRC.

A country risk Watchlist process identifies emerging issues and facilitates the development of mitigation strategies. Coverage of the country Watchlist process was extended in 2013 to include all countries to which the RBS Group has exposure.

A monthly report that summarises and discusses the RBS Group’s key country risks and trends is produced for the RBS Group Board.

Detailed portfolio reviews are conducted to ensure that country portfolio compositions remain aligned with the RBS Group’s country risk appetite in light of economic and political developments.

Changes in sovereign ratings or country Watchlist status trigger review of appetite and are referred to GCRC for discussion.

### Risk measurement\*

In this section, country exposure includes wholesale and retail on-balance sheet exposure (drawn amounts under lending facilities, mark-to-market derivatives positions and issuer-risk debt securities positions in the banking book and trading book) together with off-balance sheet exposure (contingent obligations and undrawn commitments).

The scope of this country exposure concept is broader than the scope of the credit risk assets concept used in the Credit risk section, as the latter does not include debt securities or securities financing transactions.

The Group also estimates its funding mismatches at risk of redenomination in vulnerable eurozone countries. These mismatches are estimated in terms of potential for additional loss rather than amounts owed and are thus determined starting from the balance sheet exposure as defined on page 176 and excluding relevant offsetting positions. The latter include exposures at low risk of redenomination, as identified through consideration of the relevant documentation, particularly the currency of exposure, governing law, court of jurisdiction, precise definition of the contract currency (for euro facilities), and location of payment. The Group also deducts offsets for provisions taken and liabilities that would be expected to re-denominate at the same time.

### Risk mitigation\*

Part of the RBS Group’s exposure is mitigated by guarantors or insurers (including export credit agencies), credit default swap (CDS) protection providers, or cash or non-cash collateral (such as commercial or residential real estate) in third countries, which will not be directly affected by a country event in the obligor’s country. For further details on credit mitigation instruments, refer to the Credit risk section.

CDS contracts are used by the RBS Group to hedge either entire portfolios or specific individual exposures. These transactions are subject to regular margining, which usually takes the form of cash collateral. For European peripheral sovereigns, credit protection is purchased from a number of major European banks, mostly outside the country of the reference entity. In a few cases where protection was bought from banks in the country of the reference entity, giving rise to wrong-way risk, this risk is mitigated through specific collateralisation and monitored weekly.

\*unaudited



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## Financial review *Risk and balance sheet management*

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### Country risk *continued*

#### Basis of reporting

The tables in this section show the Group's exposure at 31 December 2013, 2012 and 2011. The numbers are reported by country of operation of the obligor, except exposures to governments and individuals which are shown by country of residence.

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

Countries shown are those which had ratings of A+ or below from Standard and Poor's, Moody's or Fitch at 31 December 2013, where the Group's balance sheet exposure (as defined in this section) to counterparties operating (or individuals residing) in them exceeded £1.0 billion. Also included are selected eurozone countries.

The exposures are stated before taking into account risk mitigants such as guarantees, insurance or collateral (with the exception of reverse repos) which may have been put in place to reduce or eliminate exposure to country risk events. The tables do separately show the Group's CDS positions, as the Group may be either a net buyer or a net seller of protection. The CDS positions for 2013 and 2012 are by country of operation, those for 2011 are by country of incorporation.

Exposures relating to ocean-going vessels are not included as they cannot be meaningfully assigned to specific countries from a country risk perspective.

#### Definitions

*Lending* - Comprises gross loans and advances, including cash balances and risk elements in lending (REIL - refer to page 352 for definition).

*Debt securities* - Comprise securities classified as available-for-sale (AFS), loans and receivables (LAR), held-for-trading (HFT) and designated as at fair value through profit or loss (DFV). All debt securities other than LAR securities are carried at fair value. LAR debt securities are carried at amortised cost less impairment. HFT debt securities are presented as gross long positions (including DFV securities) and short positions per country. Impairment losses and exchange differences relating to AFS debt securities, together with interest, are recognised in the income statement. Other changes in the fair value of AFS securities are reported in AFS reserves, which are presented gross of tax.

*Derivatives (net)* - Comprise the mark-to-market (mtm) value of such contracts after the effect of legally enforceable netting agreements in line with the corresponding regulatory capital models, but before the effect of collateral.

*Securities financing transactions (SFT) (net)* - Comprise the mtm value of the cash and securities that are due to the Group at a future date under repurchase agreements, reverse repurchase agreements, stock borrowing, stock lending and equity financing transactions, after the effect of collateral intrinsic to the transaction and legally enforceable netting agreements. Counterparty netting is applied as per the corresponding regulatory capital approach. Additional collateral called to offset mtm positions (variation margin) is not included.

In addition and as memorandum items, the tables show derivatives gross of netting, and SFT gross of netting and collateral intrinsic to the transaction.

*Balance sheet* - Comprises lending, debt securities, derivatives (net) and SFT (net) exposures, as defined above.

*Off-balance sheet* - Comprises letters of credit, guarantees, other contingent obligations and legally committed undrawn facilities.

*Total* - Comprises balance sheet and off-balance sheet exposure, as defined above.

*Credit default swaps (CDSs)* - Under a CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. The column 'fair value' (or 'mtm value') represents the balance sheet carrying value of the resulting exposure. The mtm value of CDSs are included in derivatives against the counterparty of the trade, as opposed to the reference entity. The notional is the par value of the credit protection bought or sold and is included against the reference entity of the CDS contract.

The column 'CDS notional less fair value' represents the net effect on exposure should the CDS contracts be triggered by a credit event, assuming a zero recovery rate on the reference exposure. This net effect would be the increase in exposure arising from sold positions netted against the decrease arising from bought positions. For a sold position, the change in exposure equals the notional less the fair value amount; this represents the amount the Group would owe to its CDS counterparties if the reference entity defaulted. Positive recovery rates would tend to reduce the gross components (increases and decreases) of those numbers.

Exposures relating to credit derivative product companies and related hedges as well as Nth-to-default basket swaps have been excluded, as they cannot be meaningfully attributed to a particular reference entity or country. Exposures to CDPCs are disclosed on page 139.

*Government* - Comprises central, regional and local government.

*Eurozone periphery* - Ireland, Spain, Italy, Portugal, Greece and Cyprus.

*Other eurozone* - Austria, Estonia, Finland, Malta, Slovakia and Slovenia.

*Asset quality (AQ)* - Refer to Asset quality on page 115.

Refer to page 135 for country analysis of equity shares.

## Financial review *Risk and balance sheet management*

### Country exposure

#### Summary of country exposure

| 2013                      | Lending    |               |              |              |               |               |               | Debt securities |              | Net           |              | Balance sheet  | Off-balance sheet | Total          | CDS notional less fair value | Gross          |               |
|---------------------------|------------|---------------|--------------|--------------|---------------|---------------|---------------|-----------------|--------------|---------------|--------------|----------------|-------------------|----------------|------------------------------|----------------|---------------|
|                           | Govt       | Central banks | Other banks  | Other FI     | Corporate     | Personal      | Total lending | AFS and LAR     | HFT (net)    | Derivatives   | SFT          |                |                   |                |                              | Derivatives    | SFT           |
|                           | £m         | £m            | £m           | £m           | £m            | £m            | £m            | £m              | £m           | £m            | £m           | £m             | £m                | £m             | £m                           | £m             | £m            |
| <b>Eurozone</b>           |            |               |              |              |               |               |               |                 |              |               |              |                |                   |                |                              |                |               |
| Ireland                   | 39         | 116           | 13           | 319          | 17,440        | 17,667        | 35,594        | 46              | 248          | 900           | 73           | 36,861         | 2,710             | 39,571         | (166)                        | 2,476          | 2,329         |
| Spain                     | —          | —             | 4            | 15           | 2,913         | 318           | 3,250         | 1               | 853          | 989           | —            | 5,093          | 1,930             | 7,023          | (440)                        | 4,128          | 2,126         |
| Italy                     | —          | 22            | 64           | 410          | 968           | 26            | 1,490         | 91              | 1,240        | 1,182         | —            | 4,003          | 1,958             | 5,961          | (574)                        | 7,183          | 527           |
| Portugal                  | —          | —             | —            | 56           | 327           | 6             | 389           | 22              | 43           | 318           | —            | 772            | 280               | 1,052          | (163)                        | 418            | 614           |
| Greece                    | —          | 1             | 1            | 1            | 108           | 14            | 125           | —               | —            | 259           | —            | 384            | 25                | 409            | (12)                         | 455            | —             |
| Cyprus                    | —          | —             | —            | —            | 147           | 10            | 157           | —               | 2            | 16            | —            | 175            | 18                | 193            | —                            | 16             | —             |
| <b>Eurozone periphery</b> |            |               |              |              |               |               |               |                 |              |               |              |                |                   |                |                              |                |               |
| Germany                   | —          | 3,588         | 402          | 683          | 3,392         | 90            | 8,155         | 4,792           | 2,524        | 7,408         | 601          | 23,480         | 7,017             | 30,497         | (1,327)                      | 35,529         | 1,128         |
| France                    | 406        | —             | 1,843        | 195          | 1,796         | 79            | 4,319         | 1,218           | 1,678        | 5,660         | 631          | 13,506         | 9,583             | 23,089         | (1,723)                      | 30,644         | 7,536         |
| Netherlands               | —          | 174           | 285          | 482          | 2,076         | 22            | 3,039         | 1,598           | 819          | 5,398         | 107          | 10,961         | 6,280             | 17,241         | (75)                         | 15,388         | 835           |
| Belgium                   | —          | —             | 149          | 71           | 358           | 21            | 599           | 1               | (480)        | 2,005         | 2            | 2,127          | 1,158             | 3,285          | (122)                        | 2,966          | 594           |
| Luxembourg                | —          | 11            | 95           | 260          | 421           | 4             | 791           | 75              | 97           | 537           | 88           | 1,588          | 1,043             | 2,631          | (56)                         | 1,373          | 253           |
| Other                     | 73         | —             | 10           | 36           | 743           | 18            | 880           | 50              | 330          | 918           | 74           | 2,252          | 1,181             | 3,433          | (475)                        | 3,554          | 622           |
| <b>Total</b>              |            |               |              |              |               |               |               |                 |              |               |              |                |                   |                |                              |                |               |
| <b>eurozone</b>           | <b>518</b> | <b>3,912</b>  | <b>2,866</b> | <b>2,528</b> | <b>30,689</b> | <b>18,275</b> | <b>58,788</b> | <b>7,894</b>    | <b>7,354</b> | <b>25,590</b> | <b>1,576</b> | <b>101,202</b> | <b>33,183</b>     | <b>134,385</b> | <b>(5,133)</b>               | <b>104,130</b> | <b>16,564</b> |
| <b>Other</b>              |            |               |              |              |               |               |               |                 |              |               |              |                |                   |                |                              |                |               |
| Japan                     | —          | 1,600         | 431          | 61           | 670           | 35            | 2,797         | 72              | (172)        | 2,364         | 202          | 5,263          | 351               | 5,614          | 4                            | 9,057          | 16,445        |
| China                     | —          | —             | 1,792        | 30           | 1,063         | 33            | 2,918         | —               | 5            | 300           | —            | 3,223          | 1,023             | 4,246          | (14)                         | 372            | 830           |
| India                     | —          | —             | 718          | —            | 1,491         | 35            | 2,244         | —               | 30           | 28            | —            | 2,302          | 466               | 2,768          | (21)                         | 190            | 45            |
| Russia                    | —          | 37            | 741          | 5            | 869           | 53            | 1,705         | 149             | 2            | 19            | —            | 1,875          | 364               | 2,239          | (65)                         | 33             | 27            |
| South Korea               | —          | —             | 622          | 75           | 426           | 2             | 1,125         | 179             | 151          | 246           | —            | 1,701          | 680               | 2,381          | 176                          | 541            | 50            |
| Turkey                    | 67         | 59            | 145          | 101          | 1,018         | 24            | 1,414         | 50              | 67           | 94            | —            | 1,625          | 324               | 1,949          | (32)                         | 119            | 998           |
| Brazil                    | —          | —             | 842          | —            | 53            | 3             | 898           | —               | 57           | 55            | —            | 1,010          | 241               | 1,251          | 12                           | 118            | —             |

## Financial review *Risk and balance sheet management*

### Country risk continued

#### Country exposure continued

| 2012                      | Lending |               |             |          |           |          |               | Debt securities |           | Net         |       | Balance sheet | Off-balance sheet | Total   | CDS notional less fair value | Gross       |        |
|---------------------------|---------|---------------|-------------|----------|-----------|----------|---------------|-----------------|-----------|-------------|-------|---------------|-------------------|---------|------------------------------|-------------|--------|
|                           | Govt    | Central banks | Other banks | Other FI | Corporate | Personal | Total lending | AFS and LAR     | HFT (net) | Derivatives | SFT   |               |                   |         |                              | Derivatives | SFT    |
|                           | £m      | £m            | £m          | £m       | £m        | £m       | £m            | £m              | £m        | £m          | £m    | £m            | £m                | £m      | £m                           | £m          | £m     |
| <b>Eurozone</b>           |         |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
| Ireland                   | 42      | 73            | 99          | 395      | 18,165    | 17,890   | 36,664        | 46              | 362       | 1,206       | 503   | 38,781        | 2,817             | 41,598  | (70)                         | 2,884       | 4,915  |
| Spain                     | —       | 6             | 1           | 73       | 4,225     | 340      | 4,645         | 23              | 503       | 1,755       | —     | 6,926         | 1,511             | 8,437   | (372)                        | 5,694       | 610    |
| Italy                     | 9       | 21            | 222         | 639      | 1,475     | 23       | 2,389         | 357             | 630       | 1,766       | —     | 5,142         | 2,610             | 7,752   | (402)                        | 9,062       | 3      |
| Portugal                  | —       | —             | —           | 128      | 450       | 7        | 585           | 42              | 35        | 404         | —     | 1,066         | 302               | 1,368   | (125)                        | 498         | 26     |
| Greece                    | —       | 7             | —           | 1        | 180       | 13       | 201           | —               | 1         | 359         | —     | 561           | 28                | 589     | (30)                         | 606         | —      |
| Cyprus                    | —       | —             | —           | —        | 61        | 14       | 75            | —               | 4         | 32          | —     | 111           | 14                | 125     | —                            | 33          | —      |
| <b>Eurozone periphery</b> |         |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
|                           | 51      | 107           | 322         | 1,236    | 24,556    | 18,287   | 44,559        | 468             | 1,535     | 5,522       | 503   | 52,587        | 7,282             | 59,869  | (999)                        | 18,777      | 5,554  |
|                           | 20,005  |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
| Germany                   | —       | —             | 508         | 711      | 4,470     | 85       | 25,779        | 7,106           | 3,500     | 9,353       | 259   | 45,997        | 7,264             | 53,261  | (1,438)                      | 57,141      | 8,135  |
| France                    | 494     | 9             | 2,417       | 207      | 2,356     | 71       | 5,554         | 975             | 3,581     | 7,373       | 698   | 18,181        | 9,226             | 27,407  | (2,267)                      | 44,963      | 16,632 |
| Netherlands               | 7       | 140           | 186         | 563      | 2,755     | 26       | 3,677         | 2,028           | 668       | 8,583       | 335   | 15,291        | 7,117             | 22,408  | (1,012)                      | 23,163      | 4,602  |
| Belgium                   | —       | —             | 164         | 56       | 441       | 22       | 683           | 1               | 564       | 2,983       | —     | 4,231         | 969               | 5,200   | (214)                        | 4,753       | 476    |
| Luxembourg                | —       | 13            | 149         | 489      | 593       | 4        | 1,248         | 58              | 192       | 709         | 127   | 2,334         | 1,176             | 3,510   | (204)                        | 2,012       | 3,844  |
| Other                     | 126     | —             | 19          | 90       | 1,033     | 14       | 1,282         | —               | 666       | 1,736       | 8     | 3,692         | 1,346             | 5,038   | (436)                        | 5,974       | 1,431  |
| <b>Total</b>              |         |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
|                           | 20,274  |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
| eurozone                  | 678     | —             | 3,765       | 3,352    | 36,204    | 18,509   | 82,782        | 10,636          | 10,706    | 36,259      | 1,930 | 142,313       | 34,380            | 176,693 | (6,570)                      | 156,783     | 40,674 |
| <b>Other</b>              |         |               |             |          |           |          |               |                 |           |             |       |               |                   |         |                              |             |        |
| Japan                     | —       | 832           | 317         | 207      | 360       | 36       | 1,752         | 6,373           | —         | 2,876       | 199   | 11,200        | 577               | 11,777  | (71)                         | 13,262      | 15,047 |
| China                     | 2       | —             | 420         | —        | 345       | 31       | 798           | 6               | —         | 879         | 1     | 1,684         | 507               | 2,191   | 45                           | 219         | 1,818  |
| India                     | —       | —             | 981         | 2        | 1,490     | 35       | 2,508         | 16              | —         | 23          | —     | 2,547         | 379               | 2,926   | (43)                         | 70          | 80     |
| Russia                    | —       | —             | 814         | —        | 566       | 54       | 1,434         | 139             | —         | 20          | —     | 1,593         | 369               | 1,962   | (251)                        | 24          | 15     |
| South Korea               | —       | —             | 722         | 101      | —         | 3        | 826           | 53              | —         | 46          | 26    | 951           | 196               | 1,147   | (58)                         | 213         | 94     |
| Turkey                    | 115     | 163           | 23          | 94       | 969       | 12       | 1,376         | 181             | —         | 93          | —     | 1,650         | 442               | 2,092   | (37)                         | 111         | 449    |
| Brazil                    | —       | —             | 564         | 69       | 68        | 3        | 704           | 77              | —         | 29          | —     | 810           | 261               | 1,071   | 393                          | 44          | —      |

## Financial review *Risk and balance sheet management*

| 2011                      | Lending    |               |              |              |               |               |               | Debt securities |              | Net           |              | Balance        | Off-          | Total          | CDS            | Gross          |               |
|---------------------------|------------|---------------|--------------|--------------|---------------|---------------|---------------|-----------------|--------------|---------------|--------------|----------------|---------------|----------------|----------------|----------------|---------------|
|                           | Govt       | Central       | Other        | Other        | Corporate     | Personal      | Total         | AFS and         | HFT          | Derivatives   | SFT          | sheet          | balance       |                | notional       | Derivatives    | SFT           |
|                           | £m         | £m            | £m           | £m           | £m            | £m            | £m            | £m              | £m           | £m            | £m           | £m             | £m            | £m             | value          | £m             | £m            |
| <b>Eurozone</b>           |            |               |              |              |               |               |               |                 |              |               |              |                |               |                |                |                |               |
| Ireland                   | 45         | 1,460         | 123          | 319          | 19,030        | 18,855        | 39,832        | 29              | 398          | 1,772         | 539          | 42,570         | 2,600         | 45,170         | (108)          | 20,051         | 4,622         |
| Spain                     | 9          | —             | 87           | 172          | 5,095         | 362           | 5,725         | 53              | (359)        | 2,388         | —            | 7,807          | 1,313         | 9,120          | (979)          | 6,772          | 587           |
| Italy                     | —          | 70            | 217          | 405          | 1,337         | 23            | 2,052         | 651             | (325)        | 1,798         | —            | 4,176          | 2,716         | 6,892          | (358)          | 10,423         | 304           |
| Portugal                  | —          | —             | 2            | —            | 468           | 5             | 475           | 47              | (81)         | 457           | —            | 898            | 346           | 1,244          | 58             | 571            | 217           |
| Greece                    | —          | —             | —            | 31           | 52            | 11            | 94            | —               | 97           | 336           | —            | 527            | 34            | 561            | 1              | 522            | —             |
| Cyprus                    | —          | —             | —            | 2            | 88            | 13            | 103           | —               | —            | 24            | —            | 127            | 16            | 143            | —              | 25             | 182           |
| <b>Eurozone periphery</b> | 54         | 1,530         | 429          | 929          | 26,070        | 19,269        | 48,281        | 780             | (270)        | 6,775         | 539          | 56,105         | 7,025         | 63,130         | (1,386)        | 38,364         | 5,912         |
| Germany                   | —          | 18,033        | 527          | 297          | 6,485         | 85            | 25,427        | 9,018           | 1,672        | 9,987         | 83           | 46,187         | 5,118         | 51,305         | (2,285)        | 68,307         | 5,964         |
| France                    | 481        | 3             | 1,198        | 253          | 2,995         | 78            | 5,008         | 1,859           | 3,355        | 8,541         | 410          | 19,173         | 8,421         | 27,594         | (2,633)        | 45,881         | 24,404        |
| Netherlands               | —          | —             | 313          | 446          | 2,406         | 19            | 3,184         | 2,547           | 604          | 9,406         | 166          | 15,907         | 3,375         | 19,282         | (1,179)        | 25,041         | 5,959         |
| Belgium                   | —          | —             | 240          | 27           | 289           | 20            | 576           | 10              | (97)         | 2,793         | 50           | 3,332          | 622           | 3,954          | (89)           | 8,766          | 1,949         |
| Luxembourg                | —          | —             | 132          | 440          | 1,136         | 2             | 1,710         | 57              | 102          | 958           | 23           | 2,850          | 1,781         | 4,631          | (331)          | 2,139          | 501           |
| Other                     | 121        | —             | 14           | 74           | 1,130         | 12            | 1,351         | 3               | 86           | 1,890         | —            | 3,330          | 1,010         | 4,340          | (15)           | 10,403         | 976           |
| <b>Total eurozone</b>     | <b>656</b> | <b>19,566</b> | <b>2,853</b> | <b>2,466</b> | <b>40,511</b> | <b>19,485</b> | <b>85,537</b> | <b>14,274</b>   | <b>5,452</b> | <b>40,350</b> | <b>1,271</b> | <b>146,884</b> | <b>27,352</b> | <b>174,236</b> | <b>(7,918)</b> | <b>198,901</b> | <b>45,665</b> |
| <b>Other</b>              |            |               |              |              |               |               |               |                 |              |               |              |                |               |                |                |                |               |
| Japan                     | 2,073      | —             | 657          | 96           | 458           | 52            | 3,336         | 12,407          | —            | 2,430         | 191          | 18,364         | 394           | 18,758         | (365)          | 15,409         | 12,678        |
| China                     | —          | —             | 7            | —            | 215           | 28            | 250           | 51              | —            | 335           | 3            | 639            | 248           | 887            | (62)           | 417            | 4,029         |
| India                     | —          | —             | 152          | —            | 443           | 17            | 612           | 81              | —            | 24            | —            | 717            | 555           | 1,272          | (105)          | 88             | 72            |
| Russia                    | —          | —             | 633          | —            | 399           | 60            | 1,092         | 10              | —            | 28            | —            | 1,130          | 113           | 1,243          | (343)          | 29             | 18            |
| South Korea               | —          | —             | 173          | —            | —             | 3             | 176           | 249             | —            | 60            | 97           | 582            | 129           | 711            | (22)           | 209            | 292           |
| Turkey                    | —          | —             | 1            | 392          | 122           | 16            | 531           | 303             | —            | 27            | —            | 861            | 116           | 977            | 10             | 36             | 139           |
| Brazil                    | —          | —             | 688          | 131          | 42            | 4             | 865           | 100             | —            | 20            | —            | 985            | 311           | 1,296          | (377)          | 61             | —             |

### Key points\*

- During 2013, the US dollar depreciated by 2.3% against sterling, whereas the euro appreciated by 2.2%, impacting exposures.
- Balance sheet and off-balance sheet exposures to nearly all countries declined across all broad product categories. This was because the Group maintained a cautious stance and many clients reduced debt levels. Non-Core lending declined in most countries, particularly in Spain, the Netherlands and France, reflecting the Group's risk reduction strategy. There were increases in some country exposures and products, reflecting the transfer of activities of RBS N.V. to the Group.
- Most of the Group's country risk exposure was in International Banking (primarily trade facilities, other lending and off-balance sheet exposure to corporates and financial institutions); Markets (principally derivatives and securities financing transactions with financial institutions, and HFT debt securities); Ulster Bank (mostly lending to consumers and corporates in Ireland); and Group Treasury (largely cash balances at central banks).
- Total eurozone - balance sheet exposure declined by £41.1 billion or 29% to £101.2 billion, caused mostly by significant reductions in liquidity held with the Bundesbank and in derivatives exposure to banks. Most of the latter reductions related to counterparties in the Netherlands, Germany and France, and were largely due to the sale of a part of the Group's CDS positions.

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Country risk continued

### Country exposure continued

### Key points\* continued

- Eurozone periphery - despite the appreciation of the euro against sterling, balance sheet exposure decreased to £47.3 billion, a reduction of £5.3 billion or 10%, in nearly all countries, as follows:
  - Ireland - exposure decreased by £1.9 billion to £36.9 billion, in all broad product categories. Residential and commercial real estate lending declined slightly to £16.9 billion and £10.3 billion, respectively. Provisions increased by £2.8 billion, most of which related to corporate lending.
  - Spain - exposure decreased by £1.8 billion to £5.1 billion. Corporate lending decreased by £1.3 billion to £2.9 billion, with commercial real estate lending more than halving, largely as a result of disposals in Non-Core, to £0.8 billion.
  - Italy - the £1.1 billion decrease in exposure to £4.0 billion reflected reductions in lending and derivatives to corporate clients. Net HFT debt exposure fluctuates as the Group is a market-maker in Italian government bonds. Off-balance sheet exposure to corporates and non-bank financial institutions also declined, by £0.6 billion.
  - Portugal - exposure declined further by £0.3 billion to £0.8 billion. The remaining exposure mainly consisted of corporate lending to a few large highly creditworthy clients and collateralised derivatives trading with the largest local banks.
  - Greece - exposure decreased by £0.2 billion to £0.4 billion, caused by reductions in lending and derivatives. The remaining exposure comprised mostly of collateralised derivatives exposure to banks and corporate lending, including exposure to local subsidiaries of international companies.
  - Cyprus - exposure increased slightly to £0.2 billion, most of which was covered by parental and export credit agency guarantees from elsewhere.
- Germany - balance sheet exposure decreased from £46.0 billion to £23.5 billion principally owing to a £16.4 billion reduction in cash balances held with the central bank. AFS government bonds decreased by £2.3 billion in line with treasury management strategies. Lending to corporate clients decreased by £1.1 billion, principally in the commercial real estate, oil and gas, and media sectors.
- France - balance sheet exposure decreased from £18.2 billion to £13.5 billion. The net long HFT position in government bonds declined by £1.9 billion in the course of normal trading in the rates business.
- Netherlands - balance sheet exposure decreased from £15.3 billion to £11.0 billion. Corporate lending decreased by £0.7 billion, primarily in commercial real estate. Off-balance sheet exposure to corporate clients decreased by £0.9 billion, mainly in the telecommunications, retail and food and consumer sectors.
- China - lending to banks increased by £1.4 billion to £1.8 billion. Corporate lending rose by £0.7 billion to £1.1 billion, reflecting customer demand. Derivatives exposure to public sector entities decreased by £0.5 billion to £0.2 billion owing to fluctuations in short-term hedging by clients.
- South Korea - balance sheet exposure increased by £0.8 billion to £1.7 billion, driven by increases in lending and in derivatives exposure to corporates, and sovereign debt securities.
- CDS positions - the Group approximately halved its European CDS positions by consolidating its derivatives portfolio through contract terminations to reduce risks and capital requirements in line with strategic plans, while maturities reduced the positions further. This resulted in major reductions in the gross notional value of CDS protection bought and sold. Net bought protection in terms of CDS notional less fair value, also fell by £1.4 billion to £5.1 billion, with reductions particularly in the Netherlands and France.
- Funding mismatches - the estimated funding mismatch at risk of redenomination for Ireland was £6.0 billion at the end of the year, falling from £8.5 billion a year before due to an increase in provisions and a reduction in assets. The mismatch for Spain increased to £2.0 billion, as the Group reduced its local funding (and associated cost) given the improved outlook for the country. The net positions for Italy, Portugal, Greece and Cyprus were all minimal. Overall, perceived risks of redenomination events in the eurozone declined considerably in 2013.

\*unaudited

## Financial review *Risk and balance sheet management*

### Ireland

|              | Lending<br>£m | REIL<br>£m | Provisions<br>£m | AFS and<br>LAR debt<br>securities<br>£m | AFS<br>reserves<br>£m | HFT<br>debt securities |             | Total debt<br>securities<br>£m | Net               |           | Balance<br>sheet<br>£m | Off-<br>balance<br>sheet<br>£m | Total<br>£m | Gross             |           |
|--------------|---------------|------------|------------------|-----------------------------------------|-----------------------|------------------------|-------------|--------------------------------|-------------------|-----------|------------------------|--------------------------------|-------------|-------------------|-----------|
|              |               |            |                  |                                         |                       | Long<br>£m             | Short<br>£m |                                | Derivatives<br>£m | SFT<br>£m |                        |                                |             | Derivatives<br>£m | SFT<br>£m |
| 2013         |               |            |                  |                                         |                       |                        |             |                                |                   |           |                        |                                |             |                   |           |
| Government   | 39            | —          | —                | —                                       | —                     | 9                      | 13          | (4)                            | 13                | —         | 48                     | 2                              | 50          | 22                | —         |
| Central bank | 116           | —          | —                | —                                       | —                     | —                      | —           | —                              | —                 | —         | 116                    | —                              | 116         | —                 | —         |
| Other banks  | 13            | —          | —                | —                                       | —                     | 33                     | 22          | 11                             | 544               | 73        | 641                    | —                              | 641         | 1,810             | 2,329     |
| Other FI     | 319           | —          | —                | 46                                      | —                     | 116                    | 12          | 150                            | 92                | —         | 561                    | 521                            | 1,082       | 389               | —         |
| Corporate    | 17,440        | 11,114     | 8,855            | —                                       | —                     | 142                    | 5           | 137                            | 251               | —         | 17,828                 | 1,676                          | 19,504      | 255               | —         |
| Personal     | 17,667        | 3,306      | 1,846            | —                                       | —                     | —                      | —           | —                              | —                 | —         | 17,667                 | 511                            | 18,178      | —                 | —         |
|              | 35,594        | 14,420     | 10,701           | 46                                      | —                     | 300                    | 52          | 294                            | 900               | 73        | 36,861                 | 2,710                          | 39,571      | 2,476             | 2,329     |

|              |        |        |       |    |   |     |    |     |       |     |        |       |        |       |       |
|--------------|--------|--------|-------|----|---|-----|----|-----|-------|-----|--------|-------|--------|-------|-------|
| 2012         |        |        |       |    |   |     |    |     |       |     |        |       |        |       |       |
| Government   | 42     | —      | —     | —  | — | 79  | 56 | 23  | 2     | —   | 67     | 2     | 69     | 6     | —     |
| Central bank | 73     | —      | —     | —  | — | —   | —  | —   | —     | —   | 73     | —     | 73     | —     | —     |
| Other banks  | 99     | —      | —     | 8  | — | 18  | 1  | 25  | 687   | 476 | 1,287  | —     | 1,287  | 2,377 | 3,547 |
| Other FI     | 395    | —      | —     | 38 | — | 324 | 2  | 360 | 140   | 27  | 922    | 550   | 1,472  | 413   | 1,042 |
| Corporate    | 18,165 | 11,058 | 6,226 | —  | — | —   | —  | —   | 376   | —   | 18,541 | 1,750 | 20,291 | 88    | 326   |
| Personal     | 17,890 | 3,286  | 1,686 | —  | — | —   | —  | —   | 1     | —   | 17,891 | 515   | 18,406 | —     | —     |
|              | 36,664 | 14,344 | 7,912 | 46 | — | 421 | 59 | 408 | 1,206 | 503 | 38,781 | 2,817 | 41,598 | 2,884 | 4,915 |

|              |        |        |       |    |   |     |    |     |       |     |        |       |        |        |       |
|--------------|--------|--------|-------|----|---|-----|----|-----|-------|-----|--------|-------|--------|--------|-------|
| 2011         |        |        |       |    |   |     |    |     |       |     |        |       |        |        |       |
| Government   | 45     | —      | —     | —  | — | 20  | 19 | 1   | 92    | —   | 138    | 2     | 140    | 102    | —     |
| Central bank | 1,460  | —      | —     | —  | — | —   | —  | —   | —     | —   | 1,460  | —     | 1,460  | —      | —     |
| Other banks  | 123    | —      | —     | —  | — | 195 | 14 | 181 | 945   | 478 | 1,727  | —     | 1,727  | 19,047 | 3,441 |
| Other FI     | 319    | —      | —     | 29 | — | 116 | 35 | 110 | 342   | 61  | 832    | 481   | 1,313  | 816    | 1,181 |
| Corporate    | 19,030 | 10,224 | 5,655 | —  | — | 135 | —  | 135 | 392   | —   | 19,557 | 1,578 | 21,135 | 86     | —     |
| Personal     | 18,855 | 2,258  | 1,048 | —  | — | —   | —  | —   | 1     | —   | 18,856 | 539   | 19,395 | —      | —     |
|              | 39,832 | 12,482 | 6,703 | 29 | — | 466 | 68 | 427 | 1,772 | 539 | 42,570 | 2,600 | 45,170 | 20,051 | 4,622 |

### CDS by reference entity

|             | 2013         |            |              |            | 2012         |            |              |            | 2011         |            |              |            |
|-------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|
|             | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            |
|             | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m |
| Government  | 2,287        | 2,228      | (4)          | (43)       | 2,486        | 2,525      | 72           | (71)       | 2,145        | 2,223      | 466          | (481)      |
| Other banks | —            | —          | —            | —          | 43           | 32         | 1            | (2)        | 110          | 107        | 21           | (21)       |
| Other FI    | 262          | 210        | (20)         | 12         | 436          | 354        | 21           | (32)       | 362          | 308        | 63           | (73)       |
| Corporate   | 81           | 81         | (5)          | 5          | 164          | 159        | (17)         | 17         | 425          | 322        | (11)         | 10         |
|             | 2,630        | 2,519      | (29)         | (26)       | 3,129        | 3,070      | 77           | (88)       | 3,042        | 2,960      | 539          | (565)      |

### CDS bought protection: counterparty analysis by internal asset quality band

|          | AQ1            |                  | AQ2-AQ3        |                  | AQ4-AQ9        |                  | AQ10           |                  | Total          |                  |
|----------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|          | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m |
| 2013     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 196            | (5)              | 1,218          | (3)              | 9              | —                | —              | —                | 1,423          | (8)              |
| Other FI | 396            | (5)              | 771            | (16)             | 40             | —                | —              | —                | 1,207          | (21)             |
|          | 592            | (10)             | 1,989          | (19)             | 49             | —                | —              | —                | 2,630          | (29)             |
| 2012     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 214            | 6                | 1,454          | 41               | 32             | (1)              | —              | —                | 1,700          | 46               |
| Other FI | 529            | 17               | 808            | 6                | 92             | 8                | —              | —                | 1,429          | 31               |
|          | 743            | 23               | 2,262          | 47               | 124            | 7                | —              | —                | 3,129          | 77               |

## Financial review *Risk and balance sheet management*

### Country risk continued

#### Country exposure continued

##### Spain

|             | Lending      | REIL       | Provisions | AFS and<br>LAR debt<br>securities | AFS<br>reserves | HFT<br>debt securities |             | Total debt<br>securities | Net               |           | Balance<br>sheet | Off-<br>balance<br>sheet | Total        | Gross             |              |
|-------------|--------------|------------|------------|-----------------------------------|-----------------|------------------------|-------------|--------------------------|-------------------|-----------|------------------|--------------------------|--------------|-------------------|--------------|
| 2013        | £m           | £m         | £m         | £m                                | £m              | Long<br>£m             | Short<br>£m | £m                       | Derivatives<br>£m | SFT<br>£m | £m               | £m                       | £m           | Derivatives<br>£m | SFT<br>£m    |
| Government  | —            | —          | —          | —                                 | —               | 1,468                  | 659         | 809                      | 5                 | —         | 814              | 11                       | 825          | 10                | —            |
| Other banks | 4            | —          | —          | —                                 | —               | 77                     | 91          | (14)                     | 648               | —         | 638              | 13                       | 651          | 3,718             | 2,126        |
| Other FI    | 15           | —          | —          | 1                                 | —               | 103                    | 40          | 64                       | 10                | —         | 89               | —                        | 89           | 37                | —            |
| Corporate   | 2,913        | 291        | 149        | —                                 | —               | 7                      | 12          | (5)                      | 326               | —         | 3,234            | 1,851                    | 5,085        | 363               | —            |
| Personal    | 318          | 55         | 25         | —                                 | —               | —                      | —           | —                        | —                 | —         | 318              | 55                       | 373          | —                 | —            |
|             | <b>3,250</b> | <b>346</b> | <b>174</b> | <b>1</b>                          | <b>—</b>        | <b>1,655</b>           | <b>802</b>  | <b>854</b>               | <b>989</b>        | <b>—</b>  | <b>5,093</b>     | <b>1,930</b>             | <b>7,023</b> | <b>4,128</b>      | <b>2,126</b> |

##### 2012

|              |              |            |            |           |          |              |            |            |              |          |              |              |              |              |            |
|--------------|--------------|------------|------------|-----------|----------|--------------|------------|------------|--------------|----------|--------------|--------------|--------------|--------------|------------|
| Government   | —            | —          | —          | —         | —        | 786          | 403        | 383        | 18           | —        | 401          | —            | 401          | 56           | —          |
| Central bank | 6            | —          | —          | —         | —        | —            | —          | —          | —            | —        | 6            | —            | 6            | —            | —          |
| Other banks  | 1            | —          | —          | —         | —        | 100          | 76         | 24         | 1,254        | —        | 1,279        | 8            | 1,287        | 5,116        | 610        |
| Other FI     | 73           | —          | —          | 23        | —        | 96           | 18         | 101        | 27           | —        | 201          | 90           | 291          | 50           | —          |
| Corporate    | 4,225        | 598        | 244        | —         | —        | 36           | 18         | 18         | 456          | —        | 4,699        | 1,357        | 6,056        | 472          | —          |
| Personal     | 340          | 61         | 27         | —         | —        | —            | —          | —          | —            | —        | 340          | 56           | 396          | —            | —          |
|              | <b>4,645</b> | <b>659</b> | <b>271</b> | <b>23</b> | <b>—</b> | <b>1,018</b> | <b>515</b> | <b>526</b> | <b>1,755</b> | <b>—</b> | <b>6,926</b> | <b>1,511</b> | <b>8,437</b> | <b>5,694</b> | <b>610</b> |

##### 2011

|             |              |              |            |           |            |            |            |              |              |          |              |              |              |              |            |
|-------------|--------------|--------------|------------|-----------|------------|------------|------------|--------------|--------------|----------|--------------|--------------|--------------|--------------|------------|
| Government  | 9            | —            | —          | —         | —          | 360        | 751        | (391)        | 35           | —        | (347)        | 36           | (311)        | 40           | —          |
| Other banks | 87           | —            | —          | 8         | (1)        | 162        | 214        | (44)         | 1,618        | —        | 1,661        | 6            | 1,667        | 5,177        | 120        |
| Other FI    | 172          | —            | —          | 45        | —          | 65         | 8          | 102          | 281          | —        | 555          | —            | 555          | 1,084        | 467        |
| Corporate   | 5,095        | 1,183        | 439        | —         | —          | 27         | —          | 27           | 454          | —        | 5,576        | 1,214        | 6,790        | 471          | —          |
| Personal    | 362          | —            | —          | —         | —          | —          | —          | —            | —            | —        | 362          | 57           | 419          | —            | —          |
|             | <b>5,725</b> | <b>1,183</b> | <b>439</b> | <b>53</b> | <b>(1)</b> | <b>614</b> | <b>973</b> | <b>(306)</b> | <b>2,388</b> | <b>—</b> | <b>7,807</b> | <b>1,313</b> | <b>9,120</b> | <b>6,772</b> | <b>587</b> |

### CDS by reference entity

|             | 2013         |              |              |              | 2012          |               |              |              | 2011          |               |              |                |
|-------------|--------------|--------------|--------------|--------------|---------------|---------------|--------------|--------------|---------------|---------------|--------------|----------------|
|             | Notional     |              | Fair value   |              | Notional      |               | Fair value   |              | Notional      |               | Fair value   |                |
|             | Bought<br>£m | Sold<br>£m   | Bought<br>£m | Sold<br>£m   | Bought<br>£m  | Sold<br>£m    | Bought<br>£m | Sold<br>£m   | Bought<br>£m  | Sold<br>£m    | Bought<br>£m | Sold<br>£m     |
| Government  | 5,164        | 5,159        | 176          | (204)        | 5,934         | 5,905         | 361          | (359)        | 5,151         | 5,155         | 538          | (522)          |
| Other banks | 142          | 91           | (3)          | 3            | 1,583         | 1,609         | 34           | (30)         | 1,965         | 1,937         | 154          | (152)          |
| Other FI    | 569          | 446          | 8            | 5            | 1,208         | 1,061         | 47           | (28)         | 2,411         | 2,199         | 157          | (128)          |
| Corporate   | 448          | 202          | (5)          | 5            | 2,261         | 2,011         | 7            | (4)          | 4,794         | 3,956         | 446          | (398)          |
|             | <b>6,323</b> | <b>5,898</b> | <b>176</b>   | <b>(191)</b> | <b>10,986</b> | <b>10,586</b> | <b>449</b>   | <b>(421)</b> | <b>14,321</b> | <b>13,247</b> | <b>1,295</b> | <b>(1,200)</b> |

### CDS bought protection: counterparty analysis by internal asset quality band

|          | AQ1            |                  | AQ2-AQ3        |                  | AQ4-AQ9        |                  | AQ10           |                  | Total          |                  |
|----------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|          | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m |
| 2013     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 484            | 10               | 1,930          | 94               | 919            | 20               | —              | —                | 3,333          | 124              |
| Other FI | 948            | 2                | 1,796          | 49               | 156            | 1                | 90             | —                | 2,990          | 52               |
|          | <b>1,432</b>   | <b>12</b>        | <b>3,726</b>   | <b>143</b>       | <b>1,075</b>   | <b>21</b>        | <b>90</b>      | <b>—</b>         | <b>6,323</b>   | <b>176</b>       |
| 2012     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 646            | 27               | 3,649          | 168              | 1,409          | 65               | —              | —                | 5,704          | 260              |
| Other FI | 2,331          | 72               | 2,539          | 109              | 324            | 8                | 88             | —                | 5,282          | 189              |
|          | <b>2,977</b>   | <b>99</b>        | <b>6,188</b>   | <b>277</b>       | <b>1,733</b>   | <b>73</b>        | <b>88</b>      | <b>—</b>         | <b>10,986</b>  | <b>449</b>       |

## Financial review *Risk and balance sheet management*

### Italy

|              | Lending | REIL | Provisions | AFS and<br>LAR debt<br>securities | AFS<br>reserves | HFT<br>debt securities |             | Total debt<br>securities | Net               |           | Balance<br>sheet | Off-<br>balance<br>sheet | Total | Gross             |           |
|--------------|---------|------|------------|-----------------------------------|-----------------|------------------------|-------------|--------------------------|-------------------|-----------|------------------|--------------------------|-------|-------------------|-----------|
|              | £m      | £m   | £m         | £m                                | £m              | Long<br>£m             | Short<br>£m | £m                       | Derivatives<br>£m | SFT<br>£m | £m               | £m                       | £m    | Derivatives<br>£m | SFT<br>£m |
| 2013         |         |      |            |                                   |                 |                        |             |                          |                   |           |                  |                          |       |                   |           |
| Government   | —       | —    | —          | —                                 | —               | 4,403                  | 3,218       | 1,185                    | 63                | —         | 1,248            | —                        | 1,248 | 71                | —         |
| Central bank | 22      | —    | —          | —                                 | —               | —                      | —           | —                        | —                 | —         | 22               | —                        | 22    | —                 | —         |
| Other banks  | 64      | —    | —          | —                                 | —               | 40                     | 66          | (26)                     | 700               | —         | 738              | 7                        | 745   | 6,220             | 527       |
| Other FI     | 410     | —    | —          | 91                                | —               | 52                     | 6           | 137                      | 205               | —         | 752              | 436                      | 1,188 | 210               | —         |
| Corporate    | 968     | 81   | 46         | —                                 | —               | 48                     | 13          | 35                       | 214               | —         | 1,217            | 1,503                    | 2,720 | 682               | —         |
| Personal     | 26      | —    | —          | —                                 | —               | —                      | —           | —                        | —                 | —         | 26               | 12                       | 38    | —                 | —         |
|              | 1,490   | 81   | 46         | 91                                | —               | 4,543                  | 3,303       | 1,331                    | 1,182             | —         | 4,003            | 1,958                    | 5,961 | 7,183             | 527       |

|              |       |    |   |     |     |       |       |      |       |   |       |       |       |       |   |
|--------------|-------|----|---|-----|-----|-------|-------|------|-------|---|-------|-------|-------|-------|---|
| 2012         |       |    |   |     |     |       |       |      |       |   |       |       |       |       |   |
| Government   | 9     | —  | — | —   | —   | 2,781 | 2,224 | 557  | 80    | — | 646   | —     | 646   | 131   | — |
| Central bank | 21    | —  | — | —   | —   | —     | —     | —    | —     | — | 21    | —     | 21    | —     | — |
| Other banks  | 222   | —  | — | —   | —   | 42    | 54    | (12) | 865   | — | 1,075 | 14    | 1,089 | 7,839 | 3 |
| Other FI     | 639   | —  | — | 357 | (1) | 23    | 1     | 379  | 97    | — | 1,115 | 665   | 1,780 | 98    | — |
| Corporate    | 1,475 | 21 | 5 | —   | —   | 85    | 22    | 63   | 724   | — | 2,262 | 1,919 | 4,181 | 994   | — |
| Personal     | 23    | —  | — | —   | —   | —     | —     | —    | —     | — | 23    | 12    | 35    | —     | — |
|              | 2,389 | 21 | 5 | 357 | (1) | 2,931 | 2,301 | 987  | 1,766 | — | 5,142 | 2,610 | 7,752 | 9,062 | 3 |

|              |       |     |    |     |     |       |       |       |       |   |       |       |       |        |     |
|--------------|-------|-----|----|-----|-----|-------|-------|-------|-------|---|-------|-------|-------|--------|-----|
| 2011         |       |     |    |     |     |       |       |       |       |   |       |       |       |        |     |
| Government   | —     | —   | —  | —   | —   | 4,336 | 4,725 | (389) | 90    | — | (299) | —     | (299) | 142    | —   |
| Central bank | 70    | —   | —  | —   | —   | —     | —     | —     | —     | — | 70    | —     | 70    | —      | —   |
| Other banks  | 217   | —   | —  | —   | —   | 65    | 85    | (20)  | 1,023 | — | 1,220 | 1     | 1,221 | 9,068  | 304 |
| Other FI     | 405   | —   | —  | 643 | (6) | 39    | 13    | 669   | 228   | — | 1,302 | 1,393 | 2,695 | 229    | —   |
| Corporate    | 1,337 | 318 | 86 | 8   | —   | 58    | —     | 66    | 457   | — | 1,860 | 1,309 | 3,169 | 984    | —   |
| Personal     | 23    | —   | —  | —   | —   | —     | —     | —     | —     | — | 23    | 13    | 36    | —      | —   |
|              | 2,052 | 318 | 86 | 651 | (6) | 4,498 | 4,823 | 326   | 1,798 | — | 4,176 | 2,716 | 6,892 | 10,423 | 304 |

### CDS by reference entity

|             | 2013         |            |              |            | 2012         |            |              |            | 2011         |            |              |            |
|-------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|
|             | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            |
|             | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m |
| Government  | 11,753       | 11,800     | 499          | (707)      | 13,023       | 13,034     | 700          | (754)      | 12,046       | 12,192     | 1,736        | (1,704)    |
| Other banks | 838          | 730        | (19)         | 20         | 3,535        | 3,488      | 163          | (139)      | 6,033        | 5,933      | 1,209        | (1,186)    |
| Other FI    | 181          | 159        | (5)          | 4          | 909          | 883        | 16           | (11)       | 879          | 762        | 60           | (51)       |
| Corporate   | 749          | 470        | (23)         | 19         | 2,924        | 2,598      | 48           | (37)       | 4,711        | 4,293      | 347          | (280)      |
|             | 13,521       | 13,159     | 452          | (664)      | 20,391       | 20,003     | 927          | (941)      | 23,669       | 23,180     | 3,352        | (3,221)    |

### CDS bought protection: counterparty analysis by internal asset quality band

|          | AQ1            |                  | AQ2-AQ3        |                  | AQ4-AQ9        |                  | AQ10           |                  | Total          |                  |
|----------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|          | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m |
| 2013     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 1,863          | 60               | 5,754          | 261              | 2,471          | 2                | —              | —                | 10,088         | 323              |
| Other FI | 541            | 6                | 2,845          | 123              | —              | —                | 47             | —                | 3,433          | 129              |
| Total    | 2,404          | 66               | 8,599          | 384              | 2,471          | 2                | 47             | —                | 13,521         | 452              |
| 2012     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 2,147          | 82               | 7,968          | 442              | 3,230          | 100              | —              | —                | 13,345         | 624              |
| Other FI | 2,194          | 94               | 4,469          | 197              | 271            | 12               | 112            | —                | 7,046          | 303              |
|          | 4,341          | 176              | 12,437         | 639              | 3,501          | 112              | 112            | —                | 20,391         | 927              |



## Financial review *Risk and balance sheet management*

### Country risk continued

#### Country exposure continued

##### Portugal

|             | Lending | REIL | Provisions | AFS and<br>LAR debt<br>securities | AFS<br>reserves | HFT<br>debt securities |             | Total debt<br>securities | Net               |           | Balance<br>sheet | Off-<br>balance<br>sheet | Total | Gross             |           |
|-------------|---------|------|------------|-----------------------------------|-----------------|------------------------|-------------|--------------------------|-------------------|-----------|------------------|--------------------------|-------|-------------------|-----------|
| 2013        | £m      | £m   | £m         | £m                                | £m              | Long<br>£m             | Short<br>£m | £m                       | Derivatives<br>£m | SFT<br>£m | £m               | £m                       | £m    | Derivatives<br>£m | SFT<br>£m |
| Government  | —       | —    | —          | —                                 | —               | 73                     | 52          | 21                       | 14                | —         | 35               | —                        | 35    | 14                | —         |
| Other banks | —       | —    | —          | —                                 | —               | 12                     | 7           | 5                        | 233               | —         | 238              | —                        | 238   | 301               | 614       |
| Other FI    | 56      | —    | —          | 1                                 | —               | 17                     | —           | 18                       | 13                | —         | 87               | 29                       | 116   | 40                | —         |
| Corporate   | 327     | 127  | 99         | 21                                | —               | —                      | —           | 21                       | 58                | —         | 406              | 243                      | 649   | 63                | —         |
| Personal    | 6       | —    | —          | —                                 | —               | —                      | —           | —                        | —                 | —         | 6                | 8                        | 14    | —                 | —         |
|             | 389     | 127  | 99         | 22                                | —               | 102                    | 59          | 65                       | 318               | —         | 772              | 280                      | 1,052 | 418               | 614       |

##### 2012

|             |     |     |     |    |   |    |    |    |     |   |       |     |       |     |    |
|-------------|-----|-----|-----|----|---|----|----|----|-----|---|-------|-----|-------|-----|----|
| Government  | —   | —   | —   | —  | — | 28 | 15 | 13 | 17  | — | 30    | —   | 30    | 17  | —  |
| Other banks | —   | —   | —   | —  | — | 5  | —  | 5  | 330 | — | 335   | —   | 335   | 421 | 26 |
| Other FI    | 128 | —   | —   | 1  | — | 21 | 11 | 11 | 2   | — | 141   | 4   | 145   | 2   | —  |
| Corporate   | 450 | 253 | 188 | 41 | — | 7  | —  | 48 | 55  | — | 553   | 290 | 843   | 58  | —  |
| Personal    | 7   | —   | —   | —  | — | —  | —  | —  | —   | — | 7     | 8   | 15    | —   | —  |
|             | 585 | 253 | 188 | 42 | — | 61 | 26 | 77 | 404 | — | 1,066 | 302 | 1,368 | 498 | 26 |

##### 2011

|             |     |   |   |    |   |    |     |       |     |   |      |     |       |     |     |
|-------------|-----|---|---|----|---|----|-----|-------|-----|---|------|-----|-------|-----|-----|
| Government  | —   | — | — | —  | — | 36 | 152 | (116) | 19  | — | (97) | —   | (97)  | 25  | —   |
| Other banks | 2   | — | — | —  | — | 12 | 2   | 10    | 371 | — | 383  | 2   | 385   | 479 | 217 |
| Other FI    | —   | — | — | 5  | — | 7  | —   | 12    | 8   | — | 20   | 134 | 154   | 8   | —   |
| Corporate   | 468 | — | — | 42 | — | 18 | —   | 60    | 59  | — | 587  | 202 | 789   | 59  | —   |
| Personal    | 5   | — | — | —  | — | —  | —   | —     | —   | — | 5    | 8   | 13    | —   | —   |
|             | 475 | — | — | 47 | — | 73 | 154 | (34)  | 457 | — | 898  | 346 | 1,244 | 571 | 217 |

### CDS by reference entity

|             | 2013         |            |              |            | 2012         |            |              |            | 2011         |            |              |            |
|-------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|
|             | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            |
|             | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m |
| Government  | 3,068        | 3,017      | 217          | (240)      | 3,182        | 3,134      | 302          | (275)      | 3,304        | 3,413      | 997          | (985)      |
| Other banks | 99           | 91         | (1)          | 3          | 856          | 863        | 31           | (30)       | 1,197        | 1,155      | 264          | (260)      |
| Other FI    | 16           | 13         | —            | (1)        | 149          | 148        | 6            | (7)        | 8            | 5          | 1            | (1)        |
| Corporate   | 358          | 284        | (18)         | 13         | 1,053        | 948        | 5            | (10)       | 363          | 321        | 68           | (48)       |
|             | 3,541        | 3,405      | 198          | (225)      | 5,240        | 5,093      | 344          | (322)      | 4,872        | 4,894      | 1,330        | (1,294)    |

### CDS bought protection: counterparty analysis by internal asset quality band

|          | AQ1            |                  | AQ2-AQ3        |                  | AQ4-AQ9        |                  | AQ10           |                  | Total          |                  |
|----------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|          | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m |
| 2013     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 497            | 31               | 1,350          | 61               | 348            | 26               | —              | —                | 2,195          | 118              |
| Other FI | 420            | 9                | 893            | 71               | —              | —                | 33             | —                | 1,346          | 80               |
|          | 917            | 40               | 2,243          | 132              | 348            | 26               | 33             | —                | 3,541          | 198              |
| 2012     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 501            | 34               | 1,962          | 135              | 498            | 46               | —              | —                | 2,961          | 215              |
| Other FI | 916            | 42               | 1,226          | 89               | 105            | (2)              | 32             | —                | 2,279          | 129              |
|          | 1,417          | 76               | 3,188          | 224              | 603            | 44               | 32             | —                | 5,240          | 344              |

## Financial review Risk and balance sheet management

### Greece

|              |         |      |            | AFS and<br>LAR debt | AFS      | HFT             |       |            | Net         |     | Balance | Off-<br>balance |       | Gross       |     |
|--------------|---------|------|------------|---------------------|----------|-----------------|-------|------------|-------------|-----|---------|-----------------|-------|-------------|-----|
|              | Lending | REIL | Provisions | securities          | reserves | debt securities |       | Total debt | Derivatives | SFT | sheet   | sheet           | Total | Derivatives | SFT |
| 2013         | £m      | £m   | £m         | £m                  | £m       | Long            | Short | securities | £m          | £m  | £m      | £m              | £m    | £m          | £m  |
| Government   | —       | —    | —          | —                   | —        | —               | —     | —          | —           | —   | —       | —               | —     | 106         | —   |
| Central bank | 1       | —    | —          | —                   | —        | —               | —     | —          | —           | —   | 1       | —               | 1     | —           | —   |
| Other banks  | 1       | —    | —          | —                   | —        | —               | —     | —          | 226         | —   | 227     | —               | 227   | 316         | —   |
| Other FI     | 1       | —    | —          | —                   | —        | —               | —     | —          | —           | —   | 1       | —               | 1     | —           | —   |
| Corporate    | 108     | 45   | 38         | —                   | —        | —               | —     | —          | 33          | —   | 141     | 16              | 157   | 33          | —   |
| Personal     | 14      | —    | —          | —                   | —        | —               | —     | —          | —           | —   | 14      | 9               | 23    | —           | —   |
|              | 125     | 45   | 38         | —                   | —        | —               | —     | —          | 259         | —   | 384     | 25              | 409   | 455         | —   |

|              |     |    |    |   |   |   |   |     |     |     |     |     |     |     |
|--------------|-----|----|----|---|---|---|---|-----|-----|-----|-----|-----|-----|-----|
| 2012         |     |    |    |   |   |   |   |     |     |     |     |     |     |     |
| Government   | —   | —  | —  | — | — | 9 | — | 9   | 17  | —   | 26  | —   | 26  | 151 |
| Central bank | 7   | —  | —  | — | — | — | — | —   | —   | —   | 7   | —   | 7   | —   |
| Other banks  | —   | —  | —  | — | — | — | — | —   | 298 | —   | 298 | —   | 298 | 411 |
| Other FI     | 1   | —  | —  | — | — | — | 8 | (8) | —   | —   | (7) | —   | (7) | —   |
| Corporate    | 180 | 38 | 38 | — | — | — | — | 44  | —   | 224 | 19  | 243 | 44  | —   |
| Personal     | 13  | —  | —  | — | — | — | — | —   | —   | 13  | 9   | 22  | —   | —   |
|              | 201 | 38 | 38 | — | — | 9 | 8 | 1   | 359 | —   | 561 | 28  | 589 | 606 |

|             |    |   |   |   |   |     |   |    |     |   |     |    |     |     |
|-------------|----|---|---|---|---|-----|---|----|-----|---|-----|----|-----|-----|
| 2011        |    |   |   |   |   |     |   |    |     |   |     |    |     |     |
| Government  | —  | — | — | — | — | 102 | 5 | 97 | —   | — | 97  | —  | 97  | 71  |
| Other banks | —  | — | — | — | — | —   | — | —  | 289 | — | 289 | —  | 289 | 404 |
| Other FI    | 31 | — | — | — | — | —   | — | —  | 12  | — | 43  | —  | 43  | 12  |
| Corporate   | 52 | — | — | — | — | —   | — | —  | 35  | — | 87  | 25 | 112 | 35  |
| Personal    | 11 | — | — | — | — | —   | — | —  | —   | — | 11  | 9  | 20  | —   |
|             | 94 | — | — | — | — | 102 | 5 | 97 | 336 | — | 527 | 34 | 561 | 522 |

### CDS by reference entity

|             | 2013         |            |              |            | 2012         |            |              |            | 2011         |            |              |            |
|-------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|--------------|------------|
|             | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            | Notional     |            | Fair value   |            |
|             | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m | Bought<br>£m | Sold<br>£m |
| Government  | —            | —          | —            | —          | —            | —          | —            | —          | 3,158        | 3,165      | 2,228        | (2,230)    |
| Other banks | 2            | 2          | 1            | (1)        | 4            | 4          | 1            | (1)        | 22           | 22         | 3            | (3)        |
| Other FI    | —            | —          | —            | —          | —            | —          | —            | —          | 34           | 34         | 8            | (8)        |
| Corporate   | 276          | 266        | (7)          | 5          | 534          | 502        | 55           | (53)       | 434          | 428        | 144          | (142)      |
|             | 278          | 268        | (6)          | 4          | 538          | 506        | 56           | (54)       | 3,648        | 3,649      | 2,383        | (2,383)    |

### CDS bought protection: counterparty analysis by internal asset quality band

|          | AQ1            |                  | AQ2-AQ3        |                  | AQ4-AQ9        |                  | AQ10           |                  | Total          |                  |
|----------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|----------------|------------------|
|          | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m | Notional<br>£m | Fair value<br>£m |
| 2013     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 33             | —                | 58             | (2)              | 1              | —                | —              | —                | 92             | (2)              |
| Other FI | 126            | (3)              | 26             | (1)              | —              | —                | 34             | —                | 186            | (4)              |
|          | 159            | (3)              | 84             | (3)              | 1              | —                | 34             | —                | 278            | (6)              |
| 2012     |                |                  |                |                  |                |                  |                |                  |                |                  |
| Banks    | 69             | 5                | 73             | 9                | 4              | —                | —              | —                | 146            | 14               |
| Other FI | 261            | 32               | 59             | 5                | 39             | 5                | 33             | —                | 392            | 42               |
|          | 330            | 37               | 132            | 14               | 43             | 5                | 33             | —                | 538            | 56               |

| Other risks |                   |
|-------------|-------------------|
| 187         | Conduct risk      |
| 188         | Pension risk      |
| 189         | Operational risk  |
| 191         | Regulatory risk   |
| 192         | Reputational risk |
| 193         | Business risk     |
| 194         | Strategic risk    |

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## Financial review *Risk and balance sheet management*

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### Other risks\*

#### Conduct risk

##### Definition

Conduct risk is the risk that the behaviour of the RBS Group and its staff towards its customers, or in the markets in which it operates, leads to reputational damage or financial loss or both. The damage or loss could be as a result of breaches of regulatory rules or laws, or of failing to meet customers' or regulators' expectations of the RBS Group.

##### Sources of risk

Activities through which conduct risk may arise include: product design; marketing and sales; complaint handling; staff training and competence; and handling of confidential and non-public price sensitive information.

##### Governance structure

Effective conduct risk management is a commercial imperative for the RBS Group: customers, clients and counterparties demand it as a precursor to building trust. It also reflects the developing regulatory environment in the UK, with the establishment of the Financial Conduct Authority, and the increasing focus of overseas regulators on conduct risk.

The RBS Group's compliance functions are responsible for the appropriate management of conduct risk, including Anti-Money Laundering (AML); Sanctions and Terrorist Financing (STF); and Anti-Bribery and Corruption (ABC). In doing so, they design, implement and maintain a management framework, the objective of which is the consistent identification, assessment, monitoring, and reporting of conduct risk.

A conduct risk governance structure, within which all divisions are represented by senior business leaders, provides clarity on roles, responsibilities and accountabilities for conduct risk. Key elements of the governance structure are set out below.

The Conduct Risk Committee: Operating under delegated authority from the Executive Risk Forum (ERF), it has responsibility for the governance, leadership and strategic oversight of the Group-wide conduct agenda. It can escalate significant issues to the ERF and the Board Risk Committee. (Refer to page 30).

The Compliance Management Team: a sub-committee of the Conduct Risk Committee, it has the authority to act on conduct risk matters such as: risk appetite; risk management strategy and framework; and risk profile and policy.

The Board receives updates on conduct risk via monthly risk reports.

##### Risk management and measurement

The RBS Group has established a defined and measurable appetite for conduct risk to ensure commercial decisions take into account any conduct risk implications.

Placing conduct risk at the centre of the RBS Group's philosophy promotes a customer-oriented culture that informs and challenges business strategy, delivers fair outcomes, and promotes behaviours consistent with regulatory and legal standards across its retail and wholesale markets.

Throughout 2013, the foundations of the RBS Group's conduct risk framework continued to be delivered. Key milestones included:

- The completion of the phased roll-out of the RBS Group's conduct risk policies, using policy chapters to explain Group-wide conduct responsibilities;
- The development and delivery of awareness initiatives and targeted conduct risk training for each policy to assist businesses and executives in embedding the understanding of conduct risk, and to provide the necessary clarity for staff on their conduct risk requirements;
- Completion of Group-wide gap analysis and benchmarking exercise with respect to each of the conduct risk policy chapters, recording identified issues and developing and implementing remediation plans;
- Establishing a central assurance function in Group Conduct and Regulatory Affairs, covering all elements of the RBS Group's conduct risk policies, including AML, STF and ABC; and
- Establishing effective leadership and a supporting governance framework, with the participation of all divisions, to oversee the RBS Group's conduct agenda.

In 2013, the RBS Group continued to focus on strengthening the capabilities of its compliance functions, at both Group and divisional level through investment in training. To do so, it facilitated training on conduct risk, primarily through computer-based Group Policy Learning modules. Each module addresses the regulatory content of relevant RBS Group Policy Standards.

##### Risk mitigation

Assurance and monitoring activities are essential to ensure that the RBS Group can demonstrate compliance with existing rules and regulations, assess whether it is managing its conduct risks appropriately, and determine whether key controls are effective. In 2013, the RBS Group Conduct and Regulatory Affairs assurance function provided Group-wide assurance over specific compliance topics, as well as thematic process reviews.

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## Financial review *Risk and balance sheet management*

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### Other risks\* continued

#### Pension risk

##### Definition

Pension risk is the risk arising from contractual or other liabilities to, or with respect to, the Group's pension schemes, whether established for its employees or for those of a related company or otherwise. It also means the risk that the RBS Group may make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation, or because it considers that it needs to do so for some other reason.

##### Sources of risk

The Group has exposure to pension risk through its defined benefit schemes worldwide. The five largest schemes, which represent around 96% of the RBS Group's pension liabilities, are the Royal Bank of Scotland Group Pension Fund ('main scheme'), the Ulster Bank Pension Scheme (Republic of Ireland), the Ulster Bank Pension Scheme, the Royal Bank of Scotland Americas Pension Plan and the Royal Bank of Scotland International Pension Trust. The main scheme is the principal source of pension risk.

Pension scheme liabilities vary with changes in long-term interest rates and inflation as well as with pensionable salaries, the longevity of scheme members and changes in legislation. Meanwhile, pension scheme assets vary with changes in interest rates, inflation expectations, credit spreads, exchange rates and equity and property prices. The Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions, becomes insufficient to meet liabilities as they fall due. In such circumstances, the Group could be obliged (or may choose) to make additional contributions to the schemes or be required to hold additional capital to mitigate this risk.

##### Governance

The main scheme operates under a trust deed. The trustee is responsible for the investment of the main scheme's assets which are held separately from the assets of the Group. The Group and the trustee must agree on the plan to fund the main scheme. The corporate trustee, RBS Pension Trustee Limited, is a wholly owned subsidiary of The Royal Bank of Scotland plc. The trustee board currently comprises six directors selected by the RBS Group and three directors nominated by members.

The Pension Risk Committee, acting as a sub-committee of the RBS Group Asset and Liability Management Committee (GALCO), considers the RBS Group's view of pension risk. The Pension Risk Committee considers mechanisms that could potentially be used for managing risk within the funds as well as financial strategy and employee welfare implications. It also reviews actuarial assumptions from a sponsor perspective as appropriate. The Pension Risk Committee is a key component of pension risk management and serves as a formal link between the RBS Group and the Investment Executive, which acts on behalf of the trustee of the RBS Group's largest pension schemes, where risk management, asset strategy and financing issues are discussed. The Investment Executive also consults with the RBS Group to obtain its view on the appropriate level of risk within the pension fund.

For further information on the RBS Group's risk governance, see pages 29 to 35.

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#### Risk management

Risk appetite and investment policy for the schemes are defined by the trustee with quantitative and qualitative input from actuaries and investment advisers.

As the sponsor of its defined benefit pension schemes, the Group manages the risk it faces using a pension risk management framework. This encompasses risk monitoring, modelling, stress testing and reporting. As sponsor, the Group maintains an independent view of the risk inherent in its pension funds. In addition to the scrutiny provided by the Pension Risk Committee, the RBS Group also achieves this through regular pension risk monitoring and reporting to the RBS Group Board, RBS Group Executive Committee and RBS Group Board Risk Committee on the material pension schemes that the RBS Group has an obligation to support.

#### Risk measurement

Pension risk reporting is submitted to the RBS Group Board monthly in the RBS Risk Management Report. The report includes an assessment of the sensitivities of the RBS Group's pension schemes to interest rates and inflation, a breakdown of the assets by class, and measurement of the overall deficit or surplus position based on the latest data.

Throughout 2013, various pension risk stress-testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios to meet integrated PRA stress-testing requirements.

#### Risk mitigation

The trustee has taken measures partially to mitigate inflation and interest rate risks both by investing in suitable physical assets and by entering into inflation and interest rate swaps. The main scheme also uses derivatives to manage the allocation of the portfolio to different asset classes and to manage risk within asset classes. The assets of the main scheme, which represent 85% of RBS Group pension plan assets at 31 December 2013, are invested in a diversified portfolio of quoted and private equity, government and corporate fixed interest and index-linked bonds, and other assets including property and hedge funds.

Risk is also mitigated in other ways. In October 2006, the main scheme was closed to new employees. In November 2009, the RBS Group confirmed that it was making changes to the main scheme and a number of other defined benefit schemes including the introduction of a limit of 2% per annum (or the annual change in the Consumer Price Index, if lower) to the amount of any salary increase that will count for pensionable purposes.

In October 2012, the RBS Group confirmed that it was offering employees the choice between an increase to the charge made through its flexible benefits programme for membership of the main scheme by 5% of salaries or an increase in their Normal Pension Age from 60 to 65 in respect of service from October 2012 with no additional charge.

## Financial review Risk and balance sheet management

The table below shows the sensitivity of the Main scheme's assets and liabilities (measured according to IAS 19 'Employee Benefits') to changes in interest rates and equity values at the year end, taking account of the current asset allocation and hedging arrangements.

|                                                                                                            | Change<br>in value<br>of assets<br>£m | Change<br>in value of<br>liabilities<br>£m | Increase in net<br>pension<br>obligations<br>£m |
|------------------------------------------------------------------------------------------------------------|---------------------------------------|--------------------------------------------|-------------------------------------------------|
| <b>At 31 December 2013</b>                                                                                 |                                       |                                            |                                                 |
| Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields | 217                                   | 333                                        | (116)                                           |
| Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields | 595                                   | 895                                        | (300)                                           |
| Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields             | 60                                    | 1,245                                      | (1,185)                                         |
| Fall in equity values of 10%                                                                               | (894)                                 | —                                          | (894)                                           |
| <b>At 31 December 2012</b>                                                                                 |                                       |                                            |                                                 |
| Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields | 76                                    | 255                                        | (179)                                           |
| Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields | 578                                   | 995                                        | (417)                                           |
| Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields             | 71                                    | 1,261                                      | (1,190)                                         |
| Fall in equity values of 10%                                                                               | (862)                                 | —                                          | (862)                                           |
| <b>At 31 December 2011</b>                                                                                 |                                       |                                            |                                                 |
| Fall in nominal swap yields of 0.25% at all durations with no change in credit spreads or real swap yields | 106                                   | 200                                        | (94)                                            |
| Fall in real swap yields of 0.25% at all durations with no change in credit spreads or nominal swap yields | 557                                   | 911                                        | (354)                                           |
| Fall in credit spreads of 0.25% at all durations with no change in nominal or real swap yields             | 104                                   | 1,118                                      | (1,014)                                         |
| Fall in equity values of 10%                                                                               | (935)                                 | —                                          | (935)                                           |

### Operational risk

#### Definition

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

It arises from day-to-day operations and is relevant to every aspect of the RBS Group's business.

#### Sources of risk

Operational risk may arise from a failure to manage appropriately the RBS Group's operations, transactions and security. It may arise from other forms of human error, an inability to deliver change on time or adequately, or from the unavailability of technology services, the loss of customer data. It could also result from a liability or a loss arising from a defective transaction. A failure to take appropriate measures to protect assets or to take account of changes in law, are sources of risk. Fraud and theft are important sources of operational risk, as is the impact of natural and man-made disasters.

#### Governance structure

The RBS Group operates with an independent Operational Risk Second Line of Defence function comprising both a central team and teams based in each business. The function plays a leadership role by providing a forward-looking, value-adding capability, working with the business to achieve a robust risk management culture across the bank. The Group Head of Operational Risk reports to the Group Chief Risk Officer.

The Operational Risk function is responsible for the design and maintenance of the operational risk framework. The Operational Risk Policy and associated standards are incorporated in the Group Policy Framework and provide direction for the consistent identification, assessment, management, monitoring and reporting of operational risk.

The Operational Risk Executive Committee, which is a sub-committee of the RBS Group Risk Committee, acts on all operational risk matters. It is responsible for reviewing and monitoring operational risk profile strategies and frameworks across the RBS Group, ensuring they are in line with risk appetite.

#### Risk management

##### Risk appetite

The RBS Group's operational risk appetite statement is agreed by the RBS Group Board. It comprises a number of specific measures of risk, including operational risk capital adequacy, earnings volatility based on the relationship between operational risk losses and the RBS Group's estimated gross income. It also includes metrics covering control environment performance. Further refinement of the appetite measure is planned for 2014.

To confirm that the RBS Group operates within the set risk appetite, the high-level statement is aligned with the strategic risk objectives of the RBS Group. Group-level measures have been set and cascaded to divisions and supported by additional tolerances and key indicators.

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## Financial review *Risk and balance sheet management*

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### Other risks\* continued

#### Operational risk continued

Operational risk appetite measures and frameworks are reviewed annually at the ERF.

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

The operational risk cycle comprises four stages:

- Identification of risks;
- Assessment or measurement of the scale of risks;
- Management or control of risks to prevent their recurrence or minimise the potential impact; and
- Monitoring and reporting of risks.

Although the operational risk tools encompass all stages of the risk cycle, they can be broadly categorised as follows:

#### Identification and assessment

Risk assessments are used to identify and assess material operational risks and key controls across all business areas. To provide a consistent categorisation of risks and controls across the RBS Group and to support identification of risk concentrations, all risks and controls are mapped to the Group-wide risk taxonomy and the control catalogue.

The process is designed to confirm that risks are effectively managed and prioritised in line with the stated risk appetite. Controls are tested frequently to verify and validate that they remain fit for purpose and operate effectively. Risk assessments are typically conducted in a workshop environment, bringing together subject matter experts and key stakeholders from across the divisions and key functions.

In 2013, the focus was on the continued implementation and embedding of risk assessments across the RBS Group. This included the strengthening of links between risk assessments and other elements of the RBS Group operational risk framework.

#### New product risk assessment

The RBS Group's new product risk assessment process is used to ensure that risks for all new products (and material variations to existing products) are adequately identified and assessed before their launch. The assessment documentation and review includes the requirement to demonstrate that the product provides fair outcomes for customers.

The Group New Business Forum reviews and challenges proposed high risk products to ensure material risks have been adequately identified and assessed so that new products are launched in line with the RBS Group's risk appetite and strategy.

#### Risk measurement

Scenario analysis is used to assess the impact of extreme but plausible operational risks. It provides a forward-looking basis for managing risk exposures, with a structured and consistent approach to scenario scoping and measurement. In 2013, the portfolio of scenarios was further enhanced with greater coverage of the material risks to which the RBS Group is exposed.

Scenario analysis is an important component in the operational risk framework, providing senior management with valuable insight into risk exposures that could significantly affect the RBS Group's financial performance or reputation. Scenarios also provide an important link between operational risk management and measurement as a key input into the calculation of Economic Capital, and into the RBS Group's stress testing and reverse stress testing processes.

Scenarios are run in a workshop environment, bringing business and risk and control experts together, thereby providing a deeper understanding of risk exposures and allowing management to make more informed decisions on taking action.

The RBS Group further refined its approach to assessing the impact of the economic cycle on its operational risk losses by specifically assessing the impact of the PRA's published Anchor 5 scenario, which describes the impact of a series of country-specific shocks around the world on expected levels of operational risk losses and capital adequacy requirements for operational risk.

The impact of the PRA Anchor 5 scenario on the RBS Group's operational risk capital, as calculated under the standardised approach, was also projected based on the outputs of the RBS Group's stress-testing exercises. Operational risk impacts are also assessed based on additional economic stress scenarios developed internally. This is used as part of the overall stress input to capital planning and ICAAP.

#### Event and loss data management

Event and loss data management covers a set of standard requirements for the management of operational risk events and loss data. It also provides for clear and consistent communication of operational risk events that meet defined threshold criteria to the RBS Group's senior management. The RBS Group has continued to focus on the timely and accurate capture of operational risk losses; the use of a single RBS Group-wide repository; and the escalation of material operational risk events.

All losses and recoveries associated with an operational risk event are reported based on the date of each financial impact. A single event can have multiple losses (or recoveries) which may take some time to crystallise. Losses and recoveries will also have been booked in 2013 on events which occurred, or were identified in, prior years.

#### Capital

The Group calculates the Pillar 1 capital requirement for operational risk using the standardised approach (TSA). For 2013, the Group's minimum Pillar 1 capital requirement was £3.0 billion (2012 - £3.3 billion).

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## Financial review *Risk and balance sheet management*

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### Monitoring and reporting

Monitoring and reporting form an integral part of all of the RBS Group's operational risk management processes, which are designed to ensure that risks and issues are identified, escalated and managed on a timely basis. Exposures for each division are communicated through monthly risk and control reports that are discussed at divisional risk committees. The reports provide detail on the risk exposures and action plans. In 2013 the linkages between different components of the operational risk framework were improved. This has allowed better aggregation, using both qualitative and quantitative inputs from all framework elements to underpin improvements in reporting to senior committees.

### Control Environment Certification

Control Environment Certification (CEC) is used by the RBS Group Executive to review and assess its internal control framework. Members of the senior management team are required to provide a twice-yearly assessment of the robustness of the RBS Group's internal control environment including:

- Compliance with the requirements of the UK Corporate Governance Code;
- Appropriateness of the risk frameworks, culture and governance structures of each division to help ensure the RBS Group operates within risk appetite;
- Adequacy of reporting on the material risks for the business against appetite; and
- Compliance with the RBS Group Policy Framework and key divisional and functional policy standards.

CEC outcomes are reported to the Board, the RBS Group Audit Committee and the Board Risk Committee, and, shared with external auditors.

### Risk mitigation

Where a risk has been deemed to be outside of risk appetite, the business unit must decide whether this is acceptable or not. Where it is deemed unacceptable, an action plan to reduce the exposure is prepared and is monitored to conclusion through the operational risk issues management process.

The objective of the operational risk issues management framework is the adoption of a consistent approach to the management of issues and actions to mitigate risks outside appetite. This element of the operational risk framework continues to be enhanced in areas such as analysis of common issues on an aggregated basis across the RBS Group to identify emerging trends and improvements to the quality of data captured.

The RBS Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements, providing protection against financial loss once a risk has crystallised.

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### Regulatory risk

#### Definition

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

#### Sources of risk

The sources of regulatory risk arise from the RBS Group's regulatory, business or operating environment and from how the RBS Group responds to them.

#### Governance structure

The RBS Group's Regulatory Affairs team ("Regulatory Affairs") maintains well-established policies and supporting processes to ensure timely identification of, and effective responses to, changes in official requirements affecting the RBS Group. The function also maintains a structured and open engagement with the RBS Group's regulators. Regulatory Affairs underpin a range of other policies and processes that address on-going compliance with regulatory obligations (refer to the section on Conduct Risk for further information).

RBS Group Board and Executive Committee oversight of changes to regulatory requirements is supported by a Prudential Regulatory Developments Executive Steering Group (ESG), which was formed in early 2010 to provide focus on a range of key regulatory developments and the RBS Group's responses.

The ESG is augmented by more specialised Groups which cover prudential, wholesale market and retail conduct issues as well as by an RBS Americas regional forum. These bodies identify and manage regulatory developments, by cascading information and coordinating activity. Their activity includes: prioritisation, allocation of responsibility, short-term tactical mitigants, longer-term strategic responses, sharing best practice, discussion of policy views, and escalation of the need for implementation projects.

A divisional Heads of Regulatory Developments Committee supports the maintenance and continuous development of the relevant policy, known as the Political, Legislative and Regulatory Environment Policy Standard, and supporting documents, together with associated processes, tools and governance. It also oversees the RBS Group's regulatory developments operating framework to ensure it meets the needs of all divisions and functions, as well as the maintenance of the policy known as the RBS Group Relationships with Regulators Policy Standard.

Similarly, the Regulatory Relations Forum, chaired by Regulatory Affairs, has global coverage with representatives from all divisions and regions. It facilitates the sharing of key regulatory engagements and trends across the RBS Group's operations.

In addition, Regulatory Affairs ensures appropriate governance and reporting of all material regulatory reviews and other regulatory developments worldwide to relevant RBS Group committees. These committees include the RBS Group Board, the RBS Group Audit Committee, and the Board Risk Committee.



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## Financial review *Risk and balance sheet management*

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### Other risks\* continued

#### Regulatory risk continued

##### Risk management and measurement

The RBS Group believes that maintaining a strong regulatory risk framework is fundamental to ensuring sustainable growth, rebuilding its reputation and maintaining stakeholder confidence.

Regulatory Affairs' two policies are supported by risk appetite statements and by relevant benchmarking activity against the RBS Group's peer banks.

These are framed by the RBS Group's stated regulatory risk and compliance risk appetite, which says there is no appetite for material or widespread breaches of rules, expectations, regulations or laws, individually or in aggregate. It recognises, however, that genuine errors occur, and so the RBS Group accepts limited, non material regulatory risk and subsequent loss.

This is reflected in the Political, Legislative and Regulatory Environment Policy Standard, which requires that all likely changes in official policy, legislation, regulation or other requirements must be identified, and assessed for potential impact, using an internal classification system.

The regulatory risk and compliance risk appetite is also reflected in the Group Relationships with Regulators Policy Standard, which states that all significant /material contacts with regulators must be identified and managed effectively and that all information provided to the regulators must be accurate, consistent and delivered within agreed timescales.

The level of regulatory risk remained high during 2013, as policymakers and regulators continued to strengthen regulation and supervision in response to the events of 2007/2008. This can be measured in high levels of interaction with supervisory authorities such as meetings, requests for information, visits and investigations, as well as in policy developments and proposals for new rules. At 31 December 2013 the RBS Group was managing 45 "High Impact" regulatory or legislative policy initiatives, and a further 63 Medium-High Impact initiatives. In 2013 as a whole, the RBS Group had also reviewed over 305 consultations in its core markets.

Against the backdrop of intensified regulatory pressure, Regulatory Affairs has increased the size of its team, as well as improved and refined its operating model, tools, systems and processes.

A "Centres of Excellence" model was adopted in July 2013. This has brought together divisional and functional resources to manage issues more efficiently, using specialisms in existing teams and managing issues cross-divisionally.

Internal communications on regulatory issues were strengthened. This involved staff seminars and the publication of key information on internal websites, including the weekly Regulatory Affairs Flash Report, covering key regulatory developments and supervisory interactions.

Quarterly reporting to the Group Audit Committee captures all material regulatory reviews and investigations as well as other regulatory developments worldwide. The reporting also tracks the status of, and trends in, key regulatory relationships.

#### Risk mitigation

The early identification and effective management of changes in legislation and regulation, as well as other requirements that may affect the RBS Group, are critical to the successful mitigation of regulatory risk.

All regulatory and compliance changes are managed so as to ensure timely compliance readiness. Those assessed as having a "High" or "Medium-High" impact are managed especially closely with the aim of mitigating the impact through, for instance, changes to strategy or business activities, or external engagement.

RBS Regulatory Affairs also communicates information on regulatory developments and follow-up engagement with client-facing businesses and functions, helping them identify and execute any required mitigating changes to strategy or business models. The key regulatory policies are kept under annual review.

### Reputational risk

#### Definition

Reputational risk is the risk of brand damage and/or financial loss owing to a failure to meet stakeholders' expectations of the RBS Group's conduct and performance. Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business in a number of ways. It can hamper efforts to build or sustain business relationships with customers, affect staff morale, and reduce access to funding sources.

#### Sources of risk

Reputational risk can arise across a range of actions taken (or, in some cases, not taken) by the RBS Group and individuals, as well as its wider conduct, policies and practices.

#### Governance structure

The RBS Group Board has the ultimate responsibility for managing the RBS Group's reputation, although all parts of the RBS Group have responsibility for any reputational impact arising from their operations, including relationships with customers. The Board has set the RBS Group's Purpose, Vision and Values (PVV), which outline a desired reputation for the RBS Group ("to be trusted, respected and valued by our customers, shareholders and communities").

\*unaudited

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## Financial review *Risk and balance sheet management*

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Directors and senior executives are actively engaged in key strategic and transactional decisions that can have a reputational impact, for example

- Key reputational issues associated with the RBS Group's strategic plans are discussed at Board level.
- The Board Risk Committee (BRC) oversees reputational issues and is directly engaged in strategic reputational management decisions (e.g. the customer redress policy following the RBS Group's IT incident).
- The RBS Group Sustainability Committee (GSC) reviews reputational issues from a customer or sector perspective. It is responsible for reviewing the RBS Group's sustainability strategy, values and policies and aligning the RBS Group's approach to environmental, social and ethical (ESE) issues.

The Board's oversight of reputational issues is supported by structures and committees to ensure that key reputational issues are discussed at appropriate levels across the RBS Group:

- Each division has reputational filters to provide the "first line of defence" for sensitive transactions or customers. Divisions have also established committees or forums to deliberate on customers, transactions or issues that may present a reputational risk for the division. For example, the remit of the International Banking Global Capital & Sighting Committee includes a requirement to assess key reputational sensitivities associated with client transactions against defined risk appetite.
- The ESE risk management function provides guidance and sets policy to avoid reputational risk to the bank related to the RBS Group's business engagements and lending to customers in some sensitive industry sectors, such as mining. The function is supported by additional resource in the business divisions.
- The Group Risk Committee (GRC) reviews reputational issues from an organisational perspective. Its remit covers material and/or enterprise-wide risk and control matters across the RBS Group, including reputational risk, as well as a review of the overall risk culture, capability and commitment across the RBS Group.

### Risk management and measurement

The reputational risk management framework is aligned with the RBS Group's strategic objectives, its risk appetite, its focus on serving customers well, its risk appetite and the RBS Group's PVV. It is designed to embed, at different points of decision-making processes, a series of reputational filters and controls that examine products, services and activities through the lens of sustainability, transparency and fairness.

The RBS Group has put the focus on "serving customers well" at the heart of its strategic objectives that, combined with a safe and sound bank, will build a culture and reputation in line with the Group's stakeholder expectations. By serving customers well, RBS aims to be trusted, respected and valued, a sustainable model of how banks serve society. Legacy issues remain to be worked through, but dealing with them in a transparent manner is a necessary part of the ability to move forward.

The RBS Group's four corporate values (serving customers, working together, thinking long-term and doing the right thing) build on the advances made so far (e.g. strengthened governance and controls) to deliver the required cultural and behavioural change for the long term, with a set of supporting tangible measures. Key tools designed to embed the values include a revised code of conduct, a simple "yes-check" guide to decisions that need to be taken every day by employees and various training and accreditation programmes. Values will also be a core part of performance measures to endorse behaviours that benefit customers, manage risk and deliver long-term shareholder value.

The monthly risk report to the RBS Group Board contains a view of key risks, including a reputational risk impact assessment of each key risk. In addition, the divisions report on relevant barometers of reputational risk and actions to manage reputational events according to the source. The annual Group Sustainability report also covers progress on the RBS Group's sustainability principles. Emerging reputational issues are identified and assessed by a dedicated cross-divisional reputational risk working Group, and escalated through the appropriate governance channels where necessary.

### Risk mitigation

Several of the RBS Group policies address key sources of reputational risk. These policies are implemented in accordance with the RBS Group Policy Framework through divisional and functional policy standard owners. The effectiveness of these policies within each business unit is reported through the CEC process semi-annually. Reputational aspects also form a core part of the RBS conduct risk framework, with a series of enhanced policies being developed in line with the RBS Group's conduct risk appetite.

### Business risk

#### Definition

Business risk is the risk that the RBS Group suffers losses as a result of adverse variances in its revenues and/or costs related to its business plan and strategy. Such variances may be caused by internal factors such as volatility in pricing, sales volumes, and input costs or external factors such as the RBS Group's exposure to macroeconomic, regulatory and industry risks.

#### Sources of risk

Business risk exists at all levels of the organisation and is generated at the transaction level. It is affected by other risks the RBS Group faces, which could contribute to any adverse changes in the RBS Group's revenues or costs. They include funding risk, volatility in the cost of funding, non-traded interest rate risk, inflation risk, operational risk, strategic risk, regulatory risk, conduct risk and reputational risk.

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## Financial review *Risk and balance sheet management*

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### Other risks\* continued

#### Business risk continued

##### Governance structure

The RBS Group Board has ultimate responsibility for business risk through the achievement of the RBS Group's business plan. The primary responsibility for divisional financial performance rests with the divisional CEO supported by divisional ExCo and functions.

Responsibility for the management of business risk lies primarily with the Group's divisions, with oversight by Group Finance. The divisions are responsible for delivery of their business plans and the management of such factors as pricing, sales volumes, marketing spend and other factors that can introduce volatility into earnings.

##### Risk management and measurement

The RBS Group seeks to minimise its exposure to business risk, subject to its wider strategic objectives.

Business risk is identified and managed at the product and transaction level. Estimated revenue and costs, including the potential range of outcomes, are key elements in the design of any new product or investment decision. All policies that ultimately seek to manage and control financial impacts at the product and transaction level are therefore relevant to business risk management including policies on conduct, treasury and investment spend.

Business risk is reported, assessed and challenged at every governance level within the organisation. Revenue and costs are reported within divisional business line and divisional finance teams maintain a record of financial performance against plans, reporting this on a regular basis to divisional CFOs and to Group functions. Group Finance challenges divisional financial results and reports performance against plan to the Board and executive committees with a particular focus on revenue generation, cost management initiatives and risk mitigation.

Business risk is reviewed and assessed through the RBS Group's planning cycles and performance management processes.

In the planning cycles, expected and potential scenarios for revenues and costs are determined, on a bottom-up basis, through plans reflecting expectations of the external environment and the RBS Group's strategic priorities. These scenarios are tested against a range of sensitivities and stresses to identify the key risk drivers behind any potential volatility, together with management actions to address and manage them.

Group Risk operates a top-down stress testing process in parallel to the RBS Group's planning cycles, considering both severe and extreme stress scenarios. The stress test outcomes form a core part of the assessment of earnings and capital adequacy risk appetite and are approved by the Board. The measurement of change in profit and loss of the divisions under stress thereby acts as a measure of business risk. Divisions also conduct their own bottom-up stress testing exercises to assess financial performance of their businesses under stress.

In 2013, the measurement of business risk was further enhanced through greater use of downside scenarios, improved granularity of stress testing, new revenue models in some of the main divisions and the development of an economic capital related business risk measure.

Business risk is incorporated in the RBS Group's risk appetite target for earnings volatility, and an assessment of volatility in revenues and costs is a key component in determining whether the RBS Group and its underlying businesses are within risk appetite. Each division is responsible for the implementation of its business plan and the management of associated risks within approved risk appetite targets.

Expected profiles for revenues and costs are determined, on a bottom-up basis, through plans reflecting expectations of the external environment and the RBS Group's strategic priorities. These profiles are tested against a range of sensitivities and stresses to identify the key risk drivers behind any potential volatility, along with management actions to address and manage them.

##### Risk mitigation

The RBS Group operates a forecast process which identifies projected changes in, or risks to, key financial metrics and ensures appropriate actions are taken.

During 2013, the RBS Group responded to the business risk challenges that it continues to face, focusing on the management of net interest margin in order to sustain and grow revenues. In addition, it introduced cost management programmes to deliver substantial savings and flexibility in the cost base.

### Strategic risk

#### Definition

The risk that the RBS Group will make inappropriate strategic choices, or that there will be changes in the external environment to which the RBS Group fails to adapt its strategies.

#### Sources of risk

Strategic risk arises from three principal sources:

- Inadequate or inaccurate analysis of current and prospective operating conditions in the RBS Group's markets including macroeconomic performance, customer and competitor behaviours and actions, regulatory developments and technological impacts;
- Inadequate or inaccurate understanding of the RBS Group's existing capabilities and positioning and ability to implement chosen strategies; and
- Significant unanticipated changes in the RBS Group's operating environment.

Failure to manage strategic risk could have a wide-ranging impact on the RBS Group. Effects could include damage to the RBS Group's customer franchises, and lower revenues, profitability and returns to shareholders. Strategic risk is viewed as material, given the current uncertain economic climate and the potential impact of regulatory changes in the medium term.

\*unaudited

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## Financial review *Risk and balance sheet management*

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### Governance structure

The RBS Group's strategic planning process is managed by RBS Group Strategy and Corporate Finance. As part of that process, each division develops a strategic plan for its business within a framework set by the Group's senior management. Divisional plans are then consolidated at Group level, and both divisional and RBS Group plans are reviewed, challenged and assessed against risk appetite. The consolidated plan is reviewed and formally signed off by the RBS Group Board once a year.

Strategic plans are developed by each division on an annual cycle managed centrally, and are aggregated into a RBS Group plan reviewed and challenged by the RBS Group Chief Executive, RBS Group Finance Director and RBS Group Director of Strategy and Corporate Finance before presentation to the RBS Group Board. The Board has ultimate responsibility for approving strategic plans, initiatives and changes to strategic direction. In addition to the annual cycle, each division presents a more detailed individual "Deep Dive" review of key dimensions of its strategy at a RBS Group Board meeting at different points during the year.

### Risk management and measurement

The RBS Group seeks to reduce strategic risk by employing a disciplined strategic framework based on five enduring tests (leading customer franchises, returns, risk, sustainable growth, connectivity) and by assigning responsibility for strategy development to line management. Key strategies are scrutinised and approved by the RBS Group Board. This is intended to maximise the capture of market and customer insight while providing independent scrutiny and challenge. Strategic plans contain analysis of current and expected operating conditions, current and targeted competitive and market positioning, key strategic initiatives, financial and customer targets and milestones. Upside and downside risks to the strategic plans are identified.

In 2013, the RBS Group began to focus on reducing strategic risk through a wide-ranging review to analyse core activities and formulate an appropriate plan - including rationalisation where necessary - to address the business challenges of the next five years

Responsibility for the management of the bank's strategic risks resides mainly with the individual divisions. Divisional management tracks progress on the initiatives and action plans to deliver the strategy through a range of key performance indicators such as financial performance, risk metrics, market shares and numbers of customers, satisfaction scores.

Strategic progress is also monitored through quarterly performance review meetings between divisional CEOs and the RBS Group Chief Executive, RBS Group Finance Director and RBS Group Director of Strategy and Corporate Finance. While there is no formal RBS Group statement on Strategic Risk appetite, the RBS Group's strategy is approved by the RBS Group Board with consideration of the risks in pursuing that strategy.

A wide variety of financial, risk, customer and market metrics are used to monitor business performance and thus, inter alia, the effectiveness of chosen strategies. Any deviations from the expected values are analysed to determine drivers which could be strategic, environmental or management.

### Risk mitigation

A full sensitivity analysis of the strategic plan is undertaken at the end of the strategic and financial planning process, to assess the robustness of the plan under stressed conditions represented by a variety of scenarios. In certain cases, following consideration of an opportunity, the RBS Group may decide not to pursue that opportunity as a result of a perceived strategic risk.

### Developments in 2014

In late 2013, the RBS Group announced its intention to undertake a comprehensive business review. Over the remainder of 2013 and into the early months of 2014, it completed the review and developed a strategic plan, the objective of which is to position the Group as a UK-focused retail and corporate bank that earns its customers' trust by serving them better than any other bank. Key to achieving this is combining customer groups with similar needs into three new businesses and reducing significantly the RBS Group's costs and complexity. While the Group is confident that the plan is appropriate, it may have underestimated the risks arising from concentrating its activities in the UK or misunderstood the needs of its customers or the strength of its competitive position.

Even if the strategy proves to be appropriate, the RBS Group may not succeed in implementing it, particularly as doing so will make additional demands on management at a time of significant regulatory change. Finally, given the rapidity with which technology is changing its competitive environment, the Group may find that its strategy does not go far enough to enable it to compete effectively.

## Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2013.

### Group structure

The Royal Bank of Scotland plc (the 'Bank') is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc (the 'holding company'), which is incorporated in Great Britain and has its registered office at 36 St Andrew Square, Edinburgh EH2 2YB. The 'Group' comprises the Bank and its subsidiary and associated undertakings. Details of the principal subsidiary undertakings and their activities are shown in Note 17 on the accounts. 'RBS Group' comprises the holding company and its subsidiary and associated undertakings.

The financial statements of The Royal Bank of Scotland Group plc can be obtained from RBS Secretariat, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or through the RBS Group's website [www.rbs.com](http://www.rbs.com)

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the holding company. In December 2009, the holding company issued a further £25.5 billion of new capital to HMT. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital.

At 31 December 2013, HMT's holding in the holding company's ordinary shares was 63.9%.

### RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)

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

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V.").

In October 2011, the Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank. Substantially all of the Netherlands and EMEA businesses were transferred to the Royal Bank in September 2012. Russia, Korea and the North American businesses were transferred to the Royal Bank in 2013. Certain assets of RBS N.V. continue to be shared by the Consortium Members.

### Results and dividends

The loss attributable to the ordinary shareholders of the Bank for the year ended 31 December 2013 amounted to £7,309 million compared with £3,937 million for the year ended 31 December 2012, as set out in the consolidated income statement on page 202.

The Bank did not pay a dividend on ordinary shares in 2013 or 2012.

### Strategic report

#### Activities

The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its divisions and the competitive markets in which they operate, are contained in the Financial review on pages 4 to 6.

#### Risk factors

The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Certain risk factors the Group faces are summarised in the Financial review on pages 7 and 8. Fuller details of these and other risk factors are set out on pages 331 to 346.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 216 to 219.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Risk and balance sheet management of the Financial review on pages 28 to 195.

### Financial performance

A review of the Group's performance during the year ended 31 December 2013, including details of each division, and the Group's financial position as at that date is contained in the Financial review on pages 9 to 27.

### Employees

Policies and practices in respect of employee issues are managed on a consistent basis across the RBS Group, and the following sections reflect this approach.

As at 31 December 2013, the Bank and its subsidiaries employed 106,100 employees (full time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the accounts.

The RBS Group operates certain employee share plans in which eligible employees are able to participate and which align the interests of employees with those of RBS Group shareholders.



## Report of the directors

### Employee learning and development

The RBS Group maintains a strong commitment to providing all its employees with the opportunity to grow through learning and development, which in turn helps to achieve business objectives and drive excellent customer service. Supporting the professionalisation of our front line staff, just over 18,000 customer facing employees are now part of accreditation programmes aligned to the Chartered Banker professional standards. This helps our employees deliver the best service to our customers whilst working towards a recognised professional standard.

### Employee communication

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

The Group Chief Executive and other senior RBS Group executives regularly communicate with, and encourage feedback from, employees across a range of channels.

### Employee feedback

Every year since 1999, through the Your Feedback survey, employees in all our businesses have shared their thoughts about what it's like working for the RBS Group. In 2013, we renamed the survey Our View, reflecting the emphasis we place on a shared responsibility to build a better bank. The survey enables the business to monitor levels of employee satisfaction and engagement and how these compare with other companies. It also provides a further mechanism for the RBS Group to track employee perception of the progress we are making in strengthening our culture. Insights from Our View inform what the business needs to do to improve the way it works, whether it's a local issue or something that affects everyone.

### Employee consultation

The RBS Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries.

The RBS Group has a European Employee Council that provides an opportunity for elected representatives and management to discuss developments in the RBS Group's European operations.

### Diversity and inclusion

During 2013, the RBS Group executive continued its commitment to making workplace policies, processes and experiences inclusive for staff, customers and stakeholders.

Inclusion is built into various policy areas and people management processes. For example: the business continues to support disabled people, ensuring they have equal opportunities in recruitment, employment, promotion and training.

The business also supports employee-led networks, with three being introduced this year relating to the areas of disability, multi-culturalism and carers. These new networks run alongside existing ones, such as Focused Women and Rainbow, who provide personal and career development opportunities through networking and training events. This commitment to inclusion extends to supporting and participating in positive action programmes outside of the Group aimed at cultivating future leaders, including 'An Inspirational Journey' and FTSE-100 cross-company mentoring programmes. The RBS Group continues to maintain its involvement with external charitable networks and events such as Manchester Pride.

This approach to inclusion also extends to the marketplace with the RBS Women in Business specialists supporting and guiding more and more women to take the step of starting their own business.

Performance on gender diversity is monitored and reviewed at RBS Group and local level and the RBS Group remains supportive of the recommendations of Lord Davies' Report. There are currently three female directors on the Board out of a total of eleven, which exceeds Lord Davies' aspirational target of 25 per cent female Board representation.

Further details on the Board diversity policy can be found at [rbs.com/about us](http://rbs.com/about-us).

This year the business has been recognised for its work on Equality, Diversity and Inclusion by achieving platinum ranking from Opportunity Now (gender), one of only a small handful of organisations to achieve this; achieving Silver for Race for Opportunity (race); and securing a position in the Working Families Top 10.

### Wellbeing

Ensuring the wellbeing of employees is an important responsibility for the RBS Group.

A wide range of health benefits and services is in place to help employees maintain good physical and psychological health, and support them if they do become unwell. We continue to enhance and promote these services, targeting those issues that we know affect our people's ability to bring the best of themselves to work. In 2013, we made Lifematters, the Group's Employee Assistance Programme, even more accessible with the introduction of our Lifematters mobile App.

### Code of conduct

The code of conduct was fundamentally revised in 2013. How we behave forms the character of our company and dictates how others see us. "Our Code" reflects our values and applies to everyone who works for the RBS Group. It lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed.

The code of conduct is available at [rbs.com/sustainability/governance/reporting and engagement](http://rbs.com/sustainability/governance/reporting-and-engagement). It will also be provided to any person without charge, upon request.

## Report of the directors

### Sustainability

Sustainability at the RBS Group means building our future on long term thinking that focuses on our customers and supporting the communities in which they live. Our core duty is to be safe and strong. This underpins everything that RBS does and enables people to run their daily lives and businesses. This, in turn, supports economic growth and brings wider benefits to society. The final strand to building a sustainable business centres on how we choose to operate and how we can go further to shape the world in a positive way.

Sustainability is therefore not just about the many responsibilities and obligations that the Group has in a legal sense, but is about broad issues that need to be addressed to ensure that the Group is a healthy and respected business operating on a sustainable basis.

The Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups and reports to the Board.

For more information on our approach and progress read the RBS Group Sustainability Report, available on [rbs.com/sustainable](http://rbs.com/sustainable).

### Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Financial review. The risk factors which could materially affect the Group's future results are set out on pages 331 to 346. The Group's regulatory capital resources and significant developments in 2013 and anticipated future developments are detailed on pages 46 to 50. The liquidity and funding section on pages 51 to 61 describes the Group's funding and liquidity profile, including changes in key metrics and the build up of liquidity reserves.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

### Corporate governance

#### Internal control over financial reporting

The internal controls over financial reporting for the Group are consistent with those at the RBS Group level. The RBS Group is required to comply with Section 404 of the US Sarbanes-Oxley Act of 2002 and assess the effectiveness of internal control over financial reporting as of 31 December 2013.

The RBS Group assessed the effectiveness of its internal control over financial reporting as of 31 December 2013 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in 'Internal Control - Integrated Framework'.

Based on its assessment, management has concluded that, as of 31 December 2013, the RBS Group's internal control over financial reporting is effective.

The RBS Group's auditors have audited the effectiveness of the RBS Group's internal control over financial reporting and have given an unqualified opinion.

Management's report on the RBS Group's internal control over financial reporting will be filed with the Securities and Exchange Commission as part of the RBS Group's Annual Report on Form 20-F.

### Board of directors

The Board is the main decision-making forum for the Bank. It has overall responsibility for management of the business and affairs of the Group, the establishment of Group strategy and the allocation and raising of capital, and is accountable to shareholders for financial and operational performance. The Board considers strategic issues and ensures the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations. The Board's terms of reference includes key aspects of the Bank's affairs reserved for the Board's decision and are reviewed at least annually.

There are a number of areas where the Board has delegated specific responsibility to management, including the Group Chief Executive and the Group Finance Director. These include responsibility for the operational management of the Group's businesses as well as reviewing high level strategic issues and considering risk appetite, risk policies and risk management strategies in advance of these being considered by the Board and/or its Committees.

Specific delegated authorities are also in place in relation to business commitments across the Group.

The roles of Chairman and Group Chief Executive are distinct and separate, with a clear division of responsibilities. The Chairman leads the Board and ensures the effective engagement and contribution of all executive and non-executive directors. The Group Chief Executive has responsibility for all Group businesses and acts in accordance with authority delegated by the Board. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team.

*The Group Audit Committee* comprises at least three independent non-executive directors and assists the Board in discharging its responsibilities for the disclosure of the financial affairs of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group, the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit and reviews the practices of the Divisional Risk and Audit Committees.

*The Board Risk Committee* comprises at least three independent non-executive directors. It provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's performance on risk appetite and oversees the operation of the Group Policy Framework.

## Report of the directors

*The Group Performance and Remuneration Committee* comprises at least three independent non-executive directors and has oversight of the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on remuneration of executive directors.

*The Group Nominations Committee* comprises all of the non-executive directors, and is chaired by the Chairman of the Group. It assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

*The Group Sustainability Committee* comprises of independent non-executive directors and is chaired by the Senior Independent Director. It is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board committees.

*The Executive Committee* comprises the Group's most senior executives and supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations, and considers risk strategy, policy and risk management.

### Share capital

Details of the ordinary and preference share capital at 31 December 2013 are shown in Note 26 on the accounts.

### Directors

The current members of the Board of directors are shown on page 2.

Sandy Crombie, Alison Davis, Tony Di Iorio, Philip Hampton, Penny Hughes, Brendan Nelson, Baroness Noakes and Philip Scott all served throughout the year and to the date of signing of the financial statements.

Joe MacHale and Art Ryan stepped down from the Board on 14 May 2013 and 30 September 2013 respectively.

Stephen Hester and Bruce Van Saun stepped down from the Board on 30 September 2013.

Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013. Nathan has since confirmed his resignation although his leaving date is still to be agreed.

Robert Gillespie was appointed to the Board on 2 December 2013.

On 27 February 2014, it was announced that Philip Scott will step down from the Board by 31 October 2014.

On 7 March 2014, it was announced that Morten Friis will be appointed as a non-executive director with effect from 10 April 2014.

Also on 7 March 2014, it was announced that Tony Di Iorio will step down from the Board on 26 March 2014.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting.

### Directors' interests

The interests of the directors in the shares of the holding company at 31 December 2013 are disclosed in the Report and Accounts of that company. None of the directors held an interest in the loan capital of the holding company or in the shares or loan capital of the Bank or any of the subsidiaries of the Bank, during the period from 1 January 2013 to 26 March 2014.

### Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the holding company to directors, members of the Group's Executive and Management Committees, PRA/FCA Approved Persons and certain directors and/or officers of the Group's subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Group's pension schemes.

### Post balance sheet events

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

### Political donations

During 2013, no political donations were made in the UK or EU, nor any political expenditure incurred in the UK or EU.

### Directors' disclosure to auditors

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

(a) so far as the director is aware, there is no relevant audit information of which the Bank's auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

### Auditors

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

By order of the Board

Aileen Taylor  
Secretary  
26 March 2014

The Royal Bank of Scotland plc  
is registered in Scotland No. SC90312.



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## Statement of directors' responsibilities

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This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 201.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare Bank accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the Bank. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and the undertakings included in the consolidation taken as a whole; and
- the Strategic report (incorporating the Financial review) includes a fair review of the development and performance of the business and the position of the Bank and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Philip Hampton  
Chairman

Ross McEwan  
Group Chief Executive

Nathan Bostock  
Group Finance Director

26 March 2014

### Board of directors

#### Chairman

Philip Hampton

#### Executive directors

Ross McEwan  
Nathan Bostock

#### Non-executive directors

Sandy Crombie  
Alison Davis  
Tony Di Iorio  
Robert Gillespie  
Penny Hughes  
Brendan Nelson  
Baroness Noakes  
Philip Scott

## *Independent auditor's report to the members of The Royal Bank of Scotland plc*

We have audited the financial statements of The Royal Bank of Scotland plc ("the Bank") and its subsidiaries (together the "Group") for the year ended 31 December 2013 which comprise the accounting policies, the balance sheets as at 31 December 2013, the consolidated income statement, the consolidated statement of comprehensive income, the statements of changes in equity and the cash flow statements for the year ended 31 December 2013, the related notes 1 to 42 and the information identified as 'audited' in the Risk and balance sheet management section of the Financial review. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union and, as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

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

As explained more fully in the statement of directors' responsibilities the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

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

### **Opinion**

#### **In our opinion:**

- the financial statements give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2013 and of the Group's loss for the year then ended;
- the Group's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the Bank's financial statements have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

### **Separate opinion in relation to IFRS as issued by the IASB**

As explained in the accounting policies, the Group in addition to complying with its legal obligation to apply IFRS as adopted by the European Union has also applied IFRS as issued by the International Accounting Standards Board (IASB).

In our opinion the Group financial statements comply with IFRS as issued by the IASB.

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

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

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

- We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:
- adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or
- the Bank financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Christopher Brough (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London, United Kingdom  
26 March 2014

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

## Consolidated income statement for the year ended 31 December 2013

|                                                    | Note | 2013<br>£m | 2012*<br>£m | 2011*<br>£m |
|----------------------------------------------------|------|------------|-------------|-------------|
| Interest receivable                                |      | 16,403     | 17,556      | 19,110      |
| Interest payable                                   |      | (5,809)    | (6,924)     | (7,812)     |
| Net interest income                                | 1    | 10,594     | 10,632      | 11,298      |
| Fees and commissions receivable                    | 2    | 5,380      | 5,558       | 5,898       |
| Fees and commissions payable                       | 2    | (911)      | (963)       | (1,047)     |
| Income from trading activities                     | 2    | 2,974      | 1,511       | 2,014       |
| Gain on redemption of own debt                     | 2    | 162        | 454         | 255         |
| Other operating income                             | 2    | 1,576      | 1,296       | 3,388       |
| Non-interest income                                |      | 9,181      | 7,856       | 10,508      |
| Total income                                       |      | 19,775     | 18,488      | 21,806      |
| Staff costs                                        |      | (7,006)    | (7,585)     | (7,714)     |
| Premises and equipment                             |      | (2,304)    | (2,080)     | (2,083)     |
| Other administrative expenses                      |      | (7,082)    | (5,468)     | (4,229)     |
| Depreciation and amortisation                      |      | (1,272)    | (1,614)     | (1,590)     |
| Write-down of goodwill and other intangible assets |      | (423)      | (51)        | (80)        |
| Operating expenses                                 | 3    | (18,087)   | (16,798)    | (15,696)    |
| Profit before impairment losses                    |      | 1,688      | 1,690       | 6,110       |
| Impairment losses                                  | 13   | (8,449)    | (5,214)     | (7,176)     |
| Operating loss before tax                          |      | (6,761)    | (3,524)     | (1,066)     |
| Tax charge                                         | 6    | (503)      | (336)       | (680)       |
| Loss for the year                                  |      | (7,264)    | (3,860)     | (1,746)     |
| Loss attributable to:                              |      |            |             |             |
| Non-controlling interests                          |      | (13)       | 19          | (8)         |
| Preference shareholders                            | 7    | 58         | 58          | 58          |
| Ordinary shareholders                              |      | (7,309)    | (3,937)     | (1,796)     |
|                                                    |      | (7,264)    | (3,860)     | (1,746)     |

\*Restated

The accompanying notes on pages 220 to 327, the accounting policies on pages 208 to 219 and the audited sections of the Financial review: Risk and balance sheet management on pages 28 to 195 form an integral part of these financial statements.

## Consolidated statement of comprehensive income for the year ended 31 December 2013

|                                                       | Note | 2013<br>£m | 2012*<br>£m | 2011*<br>£m |
|-------------------------------------------------------|------|------------|-------------|-------------|
| Loss for the year                                     |      | (7,264)    | (3,860)     | (1,746)     |
| Items that do not qualify for reclassification        |      |            |             |             |
| Actuarial gains/(losses) on defined benefit plans     | 4    | 443        | (2,130)     | (419)       |
| Tax                                                   |      | (246)      | 373         | 37          |
|                                                       |      | 197        | (1,757)     | (382)       |
| Items that do qualify for reclassification            |      |            |             |             |
| Available-for-sale financial assets                   |      | (1,907)    | (680)       | 1,729       |
| Cash flow hedges                                      |      | (2,485)    | 1,022       | 1,487       |
| Currency translation                                  |      | (197)      | (787)       | (226)       |
| Tax                                                   |      | 1,101      | (20)        | (815)       |
|                                                       |      | (3,488)    | 465         | 2,175       |
| Other comprehensive (loss)/income after tax           |      | (3,291)    | (2,222)     | 1,793       |
| Total comprehensive (loss)/income for the year        |      | (10,555)   | (6,082)     | 47          |
| Total comprehensive (loss)/income is attributable to: |      |            |             |             |
| Non-controlling interests                             |      | (10)       | 15          | (37)        |
| Preference shareholders                               |      | 58         | 58          | 58          |
| Ordinary shareholders                                 |      | (10,603)   | (6,155)     | 26          |
|                                                       |      | (10,555)   | (6,082)     | 47          |

\*Restated

The accompanying notes on pages 220 to 327, the accounting policies on pages 208 to 219 and the audited sections of the Financial review: Risk and balance sheet management on pages 28 to 195 form an integral part of these financial statements.

## Balance sheet as at 31 December 2013

|                                                   | Note | Group      |             |             | Bank       |             |             |
|---------------------------------------------------|------|------------|-------------|-------------|------------|-------------|-------------|
|                                                   |      | 2013<br>£m | 2012*<br>£m | 2011*<br>£m | 2013<br>£m | 2012*<br>£m | 2011*<br>£m |
| Assets                                            |      |            |             |             |            |             |             |
| Cash and balances at central banks                | 10   | 79,993     | 74,524      | 68,487      | 75,792     | 70,374      | 64,261      |
| Amounts due from subsidiaries                     | 10   | 15,058     | 21,875      | 27,232      | 41,110     | 65,671      | 58,972      |
| Other loans and advances to banks                 | 10   | 51,425     | 60,192      | 69,908      | 36,658     | 43,900      | 50,068      |
| Loans and advances to banks                       | 10   | 66,483     | 82,067      | 97,140      | 77,768     | 109,571     | 109,040     |
| Amounts due from holding company and subsidiaries | 10   | 1,620      | 1,866       | 792         | 49,945     | 55,468      | 145,757     |
| Other loans and advances to customers             | 10   | 437,480    | 492,971     | 488,607     | 175,429    | 216,081     | 205,366     |
| Loans and advances to customers                   | 10   | 439,100    | 494,837     | 489,399     | 225,374    | 271,549     | 351,123     |
| Debt securities subject to repurchase agreements  | 29   | 51,970     | 87,159      | 72,652      | 30,546     | 55,320      | 37,166      |
| Other debt securities                             |      | 48,726     | 49,426      | 96,489      | 61,781     | 67,127      | 144,294     |
| Debt securities                                   | 15   | 100,696    | 136,585     | 169,141     | 92,327     | 122,447     | 181,460     |
| Equity shares                                     | 16   | 8,278      | 13,872      | 11,762      | 7,301      | 12,766      | 10,486      |
| Investments in Group undertakings                 | 17   | —          | —           | —           | 42,328     | 40,262      | 32,164      |
| Settlement balances                               |      | 5,634      | 5,717       | 6,902       | 3,492      | 3,090       | 4,059       |
| Amounts due from holding company and subsidiaries | 14   | 3,413      | 7,200       | 10,380      | 8,967      | 14,953      | 18,457      |
| Other derivatives                                 | 14   | 285,990    | 437,901     | 522,427     | 283,913    | 434,885     | 518,840     |
| Derivatives                                       | 14   | 289,403    | 445,101     | 532,807     | 292,880    | 449,838     | 537,297     |
| Intangible assets                                 | 18   | 12,352     | 12,403      | 12,365      | 1,127      | 1,033       | 876         |
| Property, plant and equipment                     | 19   | 7,866      | 9,694       | 11,478      | 2,284      | 2,430       | 2,244       |
| Deferred tax                                      | 24   | 3,435      | 3,066       | 3,320       | 2,298      | 2,878       | 2,584       |
| Prepayments, accrued income and other assets      | 20   | 5,904      | 6,104       | 5,892       | 3,246      | 4,433       | 5,338       |
| Assets of disposal groups                         | 21   | 790        | 304         | 24,088      | —          | —           | 18,715      |
| Total assets                                      |      | 1,019,934  | 1,284,274   | 1,432,781   | 826,217    | 1,090,671   | 1,319,647   |
| Liabilities                                       |      |            |             |             |            |             |             |
| Amounts due to subsidiaries                       | 10   | 2,463      | 6,063       | 11,945      | 133,215    | 130,126     | 157,999     |
| Other deposits by banks                           | 10   | 62,700     | 96,197      | 97,152      | 47,078     | 79,457      | 76,298      |
| Deposits by banks                                 | 10   | 65,163     | 102,260     | 109,097     | 180,293    | 209,583     | 234,297     |
| Amounts due to holding company and subsidiaries   | 10   | 5,207      | 5,778       | 3,179       | 47,399     | 84,992      | 163,615     |
| Other customers accounts                          | 10   | 467,097    | 513,419     | 469,209     | 146,154    | 171,342     | 133,287     |
| Customer accounts                                 | 10   | 472,304    | 519,197     | 472,388     | 193,553    | 256,334     | 296,902     |
| Debt securities in issue                          | 10   | 59,746     | 83,278      | 140,837     | 51,538     | 71,494      | 114,524     |
| Settlement balances                               |      | 5,245      | 5,832       | 6,778       | 2,274      | 2,878       | 3,517       |
| Short positions                                   | 22   | 28,004     | 27,541      | 40,446      | 17,898     | 14,074      | 24,858      |
| Amounts due to holding company and subsidiaries   | 14   | 2,586      | 5,580       | 11,377      | 5,675      | 9,321       | 15,505      |
| Other derivatives                                 | 14   | 283,547    | 430,505     | 516,459     | 282,832    | 429,831     | 515,350     |
| Derivatives                                       | 14   | 286,133    | 436,085     | 527,836     | 288,507    | 439,152     | 530,855     |
| Accruals, deferred income and other liabilities   | 23   | 14,753     | 12,027      | 14,809      | 7,201      | 7,355       | 8,840       |
| Retirement benefit liabilities                    | 4    | 3,188      | 3,854       | 2,188       | 65         | 56          | 25          |
| Deferred tax                                      | 24   | 189        | 789         | 1,384       | —          | —           | —           |
| Amounts due to holding company                    | 10   | 19,825     | 18,184      | 15,772      | 19,399     | 18,184      | 15,772      |
| Other subordinated liabilities                    | 10   | 13,309     | 15,667      | 16,552      | 11,167     | 13,451      | 14,242      |
| Subordinated liabilities                          | 25   | 33,134     | 33,851      | 32,324      | 30,566     | 31,635      | 30,014      |
| Liabilities of disposal groups                    | 21   | 3,210      | 135         | 22,840      | —          | —           | 20,478      |
| Total liabilities                                 |      | 971,069    | 1,224,849   | 1,370,927   | 771,895    | 1,032,561   | 1,264,310   |
| Non-controlling interests                         |      | 79         | 137         | 128         | —          | —           | —           |
| Owners' equity                                    | 26   | 48,786     | 59,288      | 61,726      | 54,322     | 58,110      | 55,337      |
| Total equity                                      |      | 48,865     | 59,425      | 61,854      | 54,322     | 58,110      | 55,337      |
| Total liabilities and equity                      |      | 1,019,934  | 1,284,274   | 1,432,781   | 826,217    | 1,090,671   | 1,319,647   |

\*Restated

The accompanying notes on pages 220 to 327, the accounting policies on pages 208 to 219 and the audited sections of the Financial review: Risk and balance sheet management on pages 28 to 195 form an integral part of these financial statements.

The accounts were approved by the Board of directors on 26 March 2014 and signed on its behalf by:

Philip Hampton  
Chairman

Ross McEwan  
Group Chief Executive

Nathan Bostock  
Group Finance Director

The Royal Bank of Scotland plc  
Registration No. SC90312

## Statement of changes in equity for the year ended 31 December 2013

|                                                                           | Group*        |               |               | Bank*         |               |               |
|---------------------------------------------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                                                                           | 2013          | 2012          | 2011          | 2013          | 2012          | 2011          |
|                                                                           | £m            | £m            | £m            | £m            | £m            | £m            |
| <b>Called-up share capital</b>                                            |               |               |               |               |               |               |
| At 1 January and 31 December                                              | 6,609         | 6,609         | 6,609         | 6,609         | 6,609         | 6,609         |
| <b>Share premium account</b>                                              |               |               |               |               |               |               |
| At 1 January                                                              | 26,081        | 25,375        | 25,375        | 26,081        | 25,375        | 25,375        |
| Ordinary share issued on cross-border merger (1)                          | 209           | 706           | —             | 209           | 706           | —             |
| At 31 December                                                            | 26,290        | 26,081        | 25,375        | 26,290        | 26,081        | 25,375        |
| <b>Merger reserve</b>                                                     |               |               |               |               |               |               |
| At 1 January                                                              | 10,881        | 10,881        | 10,881        | —             | —             | —             |
| Merger reserve created on cross-border merger (1)                         | (81)          | —             | —             | (81)          | —             | —             |
| At 31 December                                                            | 10,800        | 10,881        | 10,881        | (81)          | —             | —             |
| <b>Available-for-sale reserve</b>                                         |               |               |               |               |               |               |
| At 1 January                                                              | 1,750         | 2,220         | 917           | 1,443         | 1,925         | 735           |
| Unrealised (losses)/gains                                                 | (844)         | 1,200         | 2,489         | (558)         | 1,088         | 2,294         |
| Realised gains                                                            | (1,063)       | (1,880)       | (760)         | (939)         | (1,781)       | (734)         |
| Tax                                                                       | 516           | 210           | (426)         | 356           | 211           | (370)         |
| At 31 December                                                            | 359           | 1,750         | 2,220         | 302           | 1,443         | 1,925         |
| <b>Cash flow hedging reserve</b>                                          |               |               |               |               |               |               |
| At 1 January                                                              | 1,815         | 1,018         | (81)          | 1,767         | 1,307         | 482           |
| Amount recognised in equity                                               | (1,082)       | 2,107         | 2,481         | (566)         | 1,700         | 2,486         |
| Amount transferred from equity to earnings                                | (1,403)       | (1,085)       | (994)         | (1,291)       | (1,146)       | (1,403)       |
| Tax                                                                       | 584           | (225)         | (388)         | 440           | (94)          | (258)         |
| At 31 December                                                            | (86)          | 1,815         | 1,018         | 350           | 1,767         | 1,307         |
| <b>Foreign exchange reserve</b>                                           |               |               |               |               |               |               |
| At 1 January                                                              | 2,041         | 2,829         | 3,027         | (291)         | (302)         | (317)         |
| Retranslation of net assets                                               | (287)         | (930)         | (176)         | (66)          | 11            | 15            |
| Foreign currency gains/(losses) on hedges of net assets                   | 87            | 150           | (21)          | —             | —             | —             |
| Tax                                                                       | 1             | (5)           | (1)           | —             | —             | —             |
| Recycled to profit or loss on disposal of business (nil tax)              | —             | (3)           | —             | —             | —             | —             |
| At 31 December                                                            | 1,842         | 2,041         | 2,829         | (357)         | (291)         | (302)         |
| <b>Retained earnings</b>                                                  |               |               |               |               |               |               |
| At 1 January                                                              | 10,111        | 12,794        | 10,282        | 22,501        | 20,423        | 14,660        |
| (Loss)/profit attributable to ordinary and equity preference shareholders | (7,251)       | (3,879)       | (1,738)       | (1,199)       | (781)         | 1,112         |
| Equity preference dividends paid                                          | (58)          | (58)          | (58)          | (58)          | (58)          | (58)          |
| Actuarial gains/(losses) recognised in retirement benefit schemes         |               |               |               |               |               |               |
| - gross                                                                   | 443           | (2,130)       | (419)         | (13)          | (126)         | (3)           |
| - tax                                                                     | (246)         | 373           | 37            | 6             | 26            | —             |
| Shares in holding company (released)/issued under employee share schemes  | (76)          | 30            | (39)          | (76)          | 30            | (27)          |
| Capital contribution                                                      | —             | 2,870         | 4,539         | —             | 2,870         | 4,539         |
| Share-based payments                                                      |               |               |               |               |               |               |
| - gross                                                                   | 48            | 117           | 200           | 48            | 117           | 200           |
| - tax                                                                     | 1             | (6)           | (10)          | —             | —             | —             |
| At 31 December                                                            | 2,972         | 10,111        | 12,794        | 21,209        | 22,501        | 20,423        |
| <b>Owners' equity at 31 December</b>                                      | <b>48,786</b> | <b>59,288</b> | <b>61,726</b> | <b>54,322</b> | <b>58,110</b> | <b>55,337</b> |

\*Restated

Note:  
(1) Detailed in Note 26.

## Statement of changes in equity for the year ended 31 December 2013

|                                                                                                        | Group*     |            |            | Bank*      |            |            |
|--------------------------------------------------------------------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                                                                                        | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Non-controlling interests                                                                              |            |            |            |            |            |            |
| At 1 January                                                                                           | 137        | 128        | 597        | —          | —          | —          |
| Currency translation adjustments and other movements                                                   | 3          | (4)        | (29)       | —          | —          | —          |
| (Loss)/profit attributable to non-controlling interests                                                | (13)       | 19         | (8)        | —          | —          | —          |
| Dividends paid                                                                                         | (5)        | —          | (40)       | —          | —          | —          |
| Equity raised                                                                                          | —          | 17         | —          | —          | —          | —          |
| Equity withdrawn and disposals                                                                         | (43)       | (23)       | (392)      | —          | —          | —          |
| At 31 December                                                                                         | 79         | 137        | 128        | —          | —          | —          |
| Total equity at 31 December                                                                            | 48,865     | 59,425     | 61,854     | 54,322     | 58,110     | 55,337     |
| Total comprehensive (loss)/income recognised in the statement of changes in equity is attributable to: |            |            |            |            |            |            |
| Non-controlling interests                                                                              | (10)       | 15         | (37)       | —          | —          | —          |
| Preference shareholders                                                                                | 58         | 58         | 58         | 58         | 58         | 58         |
| Ordinary shareholders                                                                                  | (10,603)   | (6,155)    | 26         | (3,888)    | (950)      | 3,082      |
|                                                                                                        | (10,555)   | (6,082)    | 47         | (3,830)    | (892)      | 3,140      |

\*Restated

The accompanying notes on pages 220 to 327, the accounting policies on pages 208 to 219 and the audited sections of the Financial review: Risk and balance sheet management on pages 28 to 195 form an integral part of these financial statements.

## Cash flow statement for the year ended 31 December 2013

|                                                               |      | Group      |            |            | Bank       |            |            |
|---------------------------------------------------------------|------|------------|------------|------------|------------|------------|------------|
|                                                               | Note | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Operating activities                                          |      |            |            |            |            |            |            |
| Operating (loss)/profit before tax                            |      | (6,761)    | (3,524)    | (1,066)    | 8          | (818)      | 1,867      |
| Adjustments for:                                              |      |            |            |            |            |            |            |
| Depreciation and amortisation                                 |      | 1,272      | 1,614      | 1,590      | 634        | 763        | 613        |
| Write-down of goodwill and other intangible assets            |      | 423        | 51         | 80         | 227        | 21         | —          |
| Provisions for impairment losses                              |      | 8,449      | 5,214      | 7,176      | 2,536      | 1,548      | 1,533      |
| Loans and advances written-off net of recoveries              |      | (3,975)    | (3,555)    | (3,675)    | (1,892)    | (1,823)    | (1,477)    |
| Interest on subordinated liabilities                          |      | 1,314      | 1,207      | 1,034      | 1,241      | 1,134      | 947        |
| Charge for defined benefit pension schemes                    |      | 513        | 512        | 531        | 11         | (3)        | 2          |
| Pension scheme curtailment gains                              |      | (3)        | (38)       | —          | (3)        | —          | —          |
| Cash contribution to defined benefit pension schemes          |      | (817)      | (888)      | (975)      | (41)       | (26)       | (3)        |
| Gain on redemption of own debt                                |      | (162)      | (454)      | (255)      | (77)       | (454)      | —          |
| Elimination of foreign exchange differences                   |      | 807        | 6,111      | 1,743      | 182        | 4,933      | 2,331      |
| Other non-cash items                                          |      | (2,847)    | (421)      | (2)        | (2,587)    | 1,343      | (685)      |
| Net cash (outflow)/inflow from trading activities             |      | (1,787)    | 5,829      | 6,181      | 239        | 6,618      | 5,128      |
| Changes in operating assets and liabilities                   |      | (18,983)   | (36,173)   | (3,645)    | (22,151)   | (56,567)   | (2,701)    |
| Net cash flows from operating activities before tax           |      | (20,770)   | (30,344)   | 2,536      | (21,912)   | (49,949)   | 2,427      |
| Income taxes (paid)/received                                  |      | (195)      | (92)       | (98)       | 322        | (84)       | (343)      |
| Net cash flows from operating activities                      | 32   | (20,965)   | (30,436)   | 2,438      | (21,590)   | (50,033)   | 2,084      |
| Investing activities                                          |      |            |            |            |            |            |            |
| Sale and maturity of securities                               |      | 33,741     | 35,388     | 64,506     | 33,660     | 64,031     | 63,905     |
| Purchase of securities                                        |      | (21,667)   | (17,724)   | (67,340)   | (14,310)   | (14,161)   | (59,607)   |
| Sale of property, plant and equipment                         |      | 888        | 2,099      | 1,794      | 83         | 137        | 42         |
| Purchase of property, plant and equipment                     |      | (697)      | (1,356)    | (3,362)    | (321)      | (531)      | (474)      |
| Net investment in business interests and intangible assets    | 33   | 4,237      | 8,245      | 6,516      | 1,646      | (129)      | 2,067      |
| Net cash flows from investing activities                      |      | 16,502     | 26,652     | 2,114      | 20,758     | 49,347     | 5,933      |
| Financing activities                                          |      |            |            |            |            |            |            |
| Issue of subordinated liabilities                             |      | 2,285      | 2,968      | 940        | 1,864      | 2,754      | 940        |
| Proceeds of non-controlling interests issued                  |      | —          | 17         | —          | —          | —          | —          |
| Capital contribution                                          |      | —          | 2,870      | 4,539      | —          | 2,870      | 4,539      |
| Redemption of non-controlling interests                       |      | (43)       | (23)       | (392)      | —          | —          | —          |
| Repayment of subordinated liabilities                         |      | (1,868)    | (264)      | (624)      | (1,868)    | —          | (193)      |
| Dividends paid                                                |      | (63)       | (58)       | (98)       | (58)       | (58)       | (58)       |
| Interest on subordinated liabilities                          |      | (1,395)    | (1,114)    | (1,062)    | (1,325)    | (1,031)    | (970)      |
| Net cash flows from financing activities                      |      | (1,084)    | 4,396      | 3,303      | (1,387)    | 4,535      | 4,258      |
| Effects of exchange rate changes on cash and cash equivalents |      | 402        | (3,347)    | (1,196)    | 604        | (2,938)    | (1,322)    |
| Net (decrease)/increase in cash and cash equivalents          |      | (5,145)    | (2,735)    | 6,659      | (1,615)    | 911        | 10,953     |
| Cash and cash equivalents at 1 January                        |      | 133,101    | 135,836    | 129,177    | 126,243    | 125,332    | 114,379    |
| Cash and cash equivalents at 31 December                      | 36   | 127,956    | 133,101    | 135,836    | 124,628    | 126,243    | 125,332    |

The accompanying notes on pages 220 to 327, the accounting policies on pages 208 to 219 and the audited sections of the 'Financial review: Risk and balance sheet management' on pages 28 to 195 form an integral part of these financial statements.



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## Accounting policies

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### 1. Presentation of accounts

The accounts are prepared on a going concern basis (see the Report of the directors, pages 198 to 201) and in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (EU) (together IFRS). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation: its financial statements are prepared in accordance with IFRS as issued by the IASB.

The Bank is incorporated in the UK and registered in Scotland and its accounts are presented in accordance with the Companies Act 2006. With the exception of investment property and certain financial instruments as described in Accounting policies 9, 14, 16, and 18 below, the accounts are presented on an historical cost basis.

The Group adopted a number of new and revised IFRSs effective 1 January 2013:

IFRS 10 'Consolidated Financial Statements' replaces SIC-12 'Consolidation - Special Purpose Entities' and the consolidation elements of the existing IAS 27 'Consolidated and Separate Financial Statements'. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity so as to vary returns for the reporting entity. IFRS 10 requires retrospective application.

IFRS 11 'Joint Arrangements', which supersedes IAS 31 'Interests in Joint Ventures', distinguishes between joint operations and joint ventures. Joint operations are accounted for by the investor recognising its assets and liabilities including its share of any assets held and liabilities incurred jointly and its share of revenues and costs. Joint ventures are accounted for in the investor's consolidated accounts using the equity method. IFRS 11 requires retrospective application.

IAS 27 'Separate Financial Statements' comprises those parts of the existing IAS 27 that deal with separate financial statements. IAS 28 'Investments in Associates and Joint Ventures' covers joint ventures as well as associates; both must be accounted for using the equity method. The mechanics of the equity method are unchanged.

IFRS 12 'Disclosure of Interests in Other Entities' mandates the disclosures in annual financial statements in respect of investments in subsidiaries, joint arrangements, associates and structured entities that are not controlled by the Group.

IFRS 13 'Fair Value Measurement' sets out a single IFRS framework for defining and measuring fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It also requires disclosures about fair value measurements.

'Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)' amended IFRS 7 to require disclosures about the effects and potential effects on an entity's financial position of offsetting financial assets and financial liabilities and related arrangements.

Amendments to IAS 1 'Presentation of Items of Other Comprehensive Income' require items that will never be recognised in profit or loss to be presented separately in other comprehensive income from those items that are subject to subsequent reclassification.

'Annual Improvements 2009-2011 Cycle' also made a number of minor changes to IFRSs.

Implementation of the standards and amendments to standards above has not had a material effect on the financial statements of the Group or the Bank.

IAS 19 'Employee Benefits' (revised) requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £84 million for the year ended 31 December 2012 (2011 - £151 million) with a corresponding increase in other comprehensive income. Prior periods have been restated.

### 2. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities (including certain structured entities) that are controlled by the Group. The Group controls another entity (a subsidiary) when it is exposed, or has rights, to variable returns from its involvement with that entity and has the ability to affect those returns through its power over the other entity; power generally arises from holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. A subsidiary is included in the consolidated financial statements from the date it is controlled by the Group until the date the Group ceases to control it through a sale or a significant change in circumstances. Changes in the Group's interest in a subsidiary that do not result in the Group ceasing to control that subsidiary are accounted for as equity transactions.

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

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## Accounting policies

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### 3. Revenue recognition

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

Financial assets and financial liabilities held for trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

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

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

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

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

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

### 4. Assets held for sale and discontinued operations

A non-current asset (or disposal group) is classified as held for sale if the Group will recover its carrying amount principally through a sale transaction rather than through continuing use. A non-current asset (or disposal group) classified as held for sale is measured at the lower of its carrying amount and fair value less costs to sell. If the asset (or disposal group) is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets and liabilities of disposal groups classified as held for sale and non-current assets classified as held for sale are shown separately on the face of the balance sheet.

### 5. Employee benefits

Short-term employee benefits, such as salaries, paid absences, and other benefits are accounted for on an accruals basis over the period in which the employees provide the related services. Employees may receive variable compensation satisfied by cash, by debt instruments issued by the RBS Group or by RBSG shares. The treatment of share-based compensation is set out in Accounting policy 25. Variable compensation that is settled in cash or debt instruments is charged to profit or loss over the period from the start of the year to which the variable compensation relates to the expected settlement date taking account of forfeiture and clawback criteria.

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

Contributions to defined contribution pension schemes are recognised in profit or loss when payable.

For defined benefit schemes, the defined benefit obligation is measured on an actuarial basis using the projected unit credit method and discounted at a rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. The difference between scheme assets and scheme liabilities – the net defined benefit asset or liability - is recognised in the balance sheet. A defined benefit asset is limited to the present value of any economic benefits available to the Group in the form of refunds from the plan or reduced contributions to it.

The charge to profit or loss for pension costs (recorded in operating expenses) comprises:

- the current service cost
- interest, computed at the rate used to discount scheme liabilities, on the net defined benefit liability or asset
- past service cost resulting from a scheme amendment or curtailment
- gains or losses on settlement.

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## Accounting policies

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A curtailment occurs when the Group significantly reduces the number of employees covered by a plan. A plan amendment occurs when the Group introduces, or withdraws, a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when benefits are withdrawn or changed so that the present value of the defined benefit obligation decreases). A settlement is a transaction that eliminates all further obligation for part or all of the benefits.

Actuarial gains and losses (i.e. gains or and losses on re-measuring of the net defined benefit asset or liability) are recognised in full in the period in which they arise in other comprehensive income.

### 6. Intangible assets and goodwill

Intangible assets acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and included in Depreciation and amortisation. These estimated useful economic lives are:

|                            |               |
|----------------------------|---------------|
| Core deposit intangibles   | 6 to 10 years |
| Other acquired intangibles | 5 to 10 years |
| Computer software          | 3 to 12 years |

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have been established. These costs include payroll, the costs of materials and services, and directly attributable overheads. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overheads. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Intangible assets include goodwill arising on the acquisition of subsidiaries and joint ventures. Goodwill on the acquisition of a subsidiary is the excess of the fair value of the consideration transferred, the fair value of any existing interest in the subsidiary and the amount of any non-controlling interest measured either at fair value or at its share of the subsidiary's net assets over the Group's interest in the net fair value of the subsidiary's identifiable assets, liabilities and contingent liabilities. Goodwill arises on the acquisition of a joint venture when the cost of investment exceeds the Group's share of the net fair value of the joint venture's identifiable assets and liabilities. Goodwill is measured at initial cost less any subsequent impairment losses. Goodwill arising on the acquisition of associates is included within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

### 7. Property, plant and equipment

Items of property, plant and equipment (except investment property - see Accounting policy 9) are stated at cost less accumulated depreciation and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Freehold land is not depreciated. The estimated useful lives of the Group's property, plant and equipment are:

|                                                                 |                               |
|-----------------------------------------------------------------|-------------------------------|
| Freehold buildings                                              | 50 years                      |
| Long leasehold property (leases with more than 50 years to run) | 50 years                      |
| Short leaseholds                                                | unexpired period of the lease |
| Property adaptation costs                                       | 10 to 15 years                |
| Computer equipment                                              | up to 5 years                 |
| Other equipment                                                 | 4 to 15 years                 |

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

### 8. Impairment of intangible assets and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

If an asset does not generate cash flows that are independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash-generating unit that have not been taken into account in estimating future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value is not greater than it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

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## Accounting policies

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### 9. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. Investment property is not depreciated but is stated at fair value. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease in Other operating income. Lease incentives granted are recognised as an integral part of the total rental income.

### 10. Foreign currencies

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

Group entities record transactions in foreign currencies in their functional currency - the currency of the primary economic environment in which they operate - at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the relevant functional currency at the foreign exchange rates ruling at the balance sheet date. Foreign exchange differences arising on the settlement of foreign currency transactions and from the translation of monetary assets and liabilities are reported in income from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations (see Accounting policy 23).

Non-monetary items denominated in foreign currencies that are stated at fair value are translated into the relevant functional currency at the foreign exchange rates ruling at the dates the values are determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are recognised in other comprehensive income unless the asset is the hedged item in a fair value hedge.

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. Income and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income. The amount accumulated in equity is reclassified from equity to profit or loss on disposal or partial disposal of a foreign operation.

### 11. Leases

#### As lessor

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

Finance lease receivables are included in the balance sheet, within Loans and advances to banks and Loans and advances to customers, at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment and included in Interest receivable. Unguaranteed residual values are subject to regular review; if there is a reduction in their value, income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is recognised in income on a straight-line basis over the lease term unless another systematic basis better represents the time pattern of the asset's use. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see Accounting policy 7). Operating lease rentals receivable are included in Other operating income.

#### As lessee

The Group's contracts to lease assets are principally operating leases. Operating lease rental expense is included in Premises and equipment costs and recognised as an expense on a straight-line basis over the lease term unless another systematic basis better represents the benefit to the Group.

### 12. Provisions

The Group recognises a provision for a present obligation resulting from a past event when it is more likely than not that it will be required to transfer economic benefits to settle the obligation and the amount of the obligation can be estimated reliably.

Provision is made for restructuring costs, including the costs of redundancy, when the Group has a constructive obligation to restructure. An obligation exists when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected by starting to implement the plan or announcing its main features.

If the Group has a contract that is onerous, it recognises the present obligation under the contract as a provision. An onerous contract is one where the unavoidable costs of meeting the Group's contractual obligations exceed the expected economic benefits. When the Group vacates a leasehold property, a provision is recognised for the costs under the lease less any expected economic benefits (such as rental income).

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

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## Accounting policies

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### 13. Tax

Income tax expense or income, comprising current tax and deferred tax, is recorded in the income statement except income tax on items recognised outside profit or loss which is credited or charged to other comprehensive income or to equity as appropriate.

Current tax is income tax payable or recoverable in respect of the taxable profit or loss for the year arising in profit or loss, other comprehensive income or equity. Provision is made for current tax at rates enacted or substantively enacted at the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that they will be recovered. Deferred tax is not recognised on temporary differences that arise from initial recognition of an asset or a liability in a transaction (other than a business combination) that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is calculated using tax rates expected to apply in the periods when the assets will be realised or the liabilities settled, based on tax rates and laws enacted, or substantively enacted, at the balance sheet date.

Deferred tax assets and liabilities are offset where the Group has a legally enforceable right to offset and where they relate to income taxes levied by the same taxation authority either on an individual Group company or on Group companies in the same tax group that intend, in future periods, to settle current tax liabilities and assets on a net basis or on a gross basis simultaneously.

### 14. Financial assets

On initial recognition, financial assets are classified into held-to-maturity investments; held-for-trading; designated as at fair value through profit or loss; loans and receivables; or available-for-sale financial assets. Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way transactions in financial assets are recognised on trade date.

*Held-to-maturity investments* - a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see Accounting policy 3) less any impairment losses.

*Held-for-trading* - a financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

*Designated as at fair value through profit or loss* - financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both, that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract. Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

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

*Available-for-sale financial assets* - financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of foreign currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see Accounting policy 3) as are gains and losses attributable to the hedged risk on available-for-sale financial assets that are hedged items in fair value hedges (see Accounting policy 23). Other changes in the fair value of available-for-sale financial assets and any related tax are reported in other comprehensive income until disposal, when the cumulative gain or loss is reclassified from equity to profit or loss.

*Reclassifications* - held-for-trading and available-for-sale financial assets that meet the definition of loans and receivables (non-derivative financial assets with fixed or determinable payments that are not quoted in an active market) may be reclassified to loans and receivables if the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. The Group typically regards the foreseeable future as twelve months from the date of reclassification. Additionally, held-for-trading financial assets that do not meet the definition of loans and receivables may, in rare circumstances, be transferred to available-for-sale financial assets or to held-to-maturity investments. Reclassifications are made at fair value. This fair value becomes the asset's new cost or amortised cost as appropriate. Gains and losses recognised up to the date of reclassification are not reversed.



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## Accounting policies

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*Fair value* - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 11.

### 15. Impairment of financial assets

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

*Financial assets carried at amortised cost* - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. For collateralised loans and receivables, estimated future cash flows include cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

Where, in the course of the orderly realisation of a loan, it is exchanged for equity shares or property, the exchange is accounted for as the sale of the loan and the acquisition of equity securities or investment property. Where the Group's interest in equity shares following the exchange is such that the Group controls an entity, that entity is consolidated. Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective impairment assessments, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of observable data, to reflect current conditions not affecting the period of historical experience. Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If, in a subsequent period, the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Impaired loans and receivables are written off, i.e. the impairment provision is applied in writing down the loan's carrying value partially or in full, when the Group concludes that there is no longer any realistic prospect of recovery of part or all of the loan. For loans that are individually assessed for impairment, the timing of write off is determined on a case-by-case basis. Such loans are reviewed regularly and write offs will be prompted by bankruptcy, insolvency, renegotiation and similar events.

Except for US retail portfolios, where write off of the irrecoverable amount takes place within 60 - 180 days, the typical time frames from initial impairment to write off for the Group's collectively-assessed portfolios are:

- Retail mortgages: write off occurs within five years, and is accelerated where accounts are closed earlier.
- Credit cards: write off of the irrecoverable amount takes place at 12 months; the rest is expected to be recovered over a further three years following which any remaining amounts outstanding are written off.
- Overdrafts and other unsecured loans: write offs occur within six years.
- Business and commercial loans: write offs of commercial loans are determined in the light of individual circumstances; the period does not exceed five years. Business loans are generally written off within five years.

Amounts recovered after a loan has been written off are credited to the loan impairment charge for the period in which they are received.

*Financial assets carried at fair value* - when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in other comprehensive income and there is objective evidence that it is impaired, the cumulative loss is reclassified from equity to profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

### 16. Financial liabilities

On initial recognition, financial liabilities are classified into held-for-trading; designated as at fair value through profit or loss; or amortised cost. Issues of financial liabilities measured at amortised cost are recognised on settlement date; all other regular way transactions in financial liabilities are recognised on trade date.

*Held-for-trading* - a financial liability is classified as held-for-trading if it is incurred principally for repurchase in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

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

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## Accounting policies

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

Financial liabilities designated as at fair value through profit or loss principally comprise structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

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

**Fair value** - the Group's approach to determining the fair value of financial instruments measured at fair value is set out in the section of Critical accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 11.

### 17. Financial guarantee contracts

Under a financial guarantee contract, the Group, in return for a fee, undertakes to meet a customer's obligations under the terms of a debt instrument if the customer fails to do so. A financial guarantee is recognised as a liability; initially at fair value and, if not designated as at fair value through profit or loss, subsequently at the higher of its initial value less cumulative amortisation and any provision under the contract measured in accordance with Accounting policy 12. Amortisation is calculated so as to recognise fees receivable in profit or loss over the period of the guarantee.

### 18. Loan commitments

Provision is made for loan commitments, other than those classified as held-for-trading, if it is probable that the facility will be drawn and the resulting loan will be recognised at a value less than the cash advanced. Syndicated loan commitments in excess of the level of lending under the commitment approved for retention by the Group are classified as held-for-trading and measured at fair value.

### 19. Derecognition

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

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires. On the redemption or settlement of debt securities (including subordinated liabilities) issued by the Group, the Group derecognises the debt instrument and records a gain or loss being the difference between the debt's carrying amount and the cost of redemption or settlement. The same treatment applies where the debt is exchanged for a new debt issue that has terms substantially different from those of the existing debt. The assessment of whether the terms of the new debt instrument are substantially different takes into account qualitative and quantitative characteristics including a comparison of the present value of the cash flows under the new terms with the present value of the remaining cash flows of the original debt issue discounted at the effective interest rate of the original debt issue.

### 20. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a financial liability. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration paid is recorded as a financial asset.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral given or received is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

### 21. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

### 22. Capital instruments

The Group classifies a financial instrument that it issues as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms and as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

Incremental costs and related tax that are directly attributable to an equity transaction are deducted from equity.

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The consideration for any ordinary shares of the company purchased by the Group (treasury shares) is deducted from equity. On the cancellation of treasury shares their nominal value is removed from equity and any excess of consideration over nominal value is treated in accordance with the capital maintenance provisions of the Companies Act. On the sale or reissue of treasury shares the consideration received and related tax are credited to equity, net of any directly attributable incremental costs.

### 23. Derivatives and hedging

Derivative financial instruments are initially recognised, and subsequently measured, at fair value. The Group's approach to determining the fair value of financial instruments is set out in the section of Critical Accounting policies and key sources of estimation uncertainty entitled Fair value - financial instruments; further details are given in Note 11.

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

Gains and losses arising from changes in the fair value of derivatives that are not the hedging instrument in a qualifying hedge are recognised as they arise in profit or loss. Gains and losses are recorded in Income from trading activities except for gains and losses on those derivatives that are managed together with financial instruments designated at fair value; these gains and losses are included in Other operating income.

The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a highly probable forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally designated and documented at inception. The documentation identifies the hedged item and the hedging instrument and details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued. Hedge accounting is also discontinued if the Group revokes the designation of a hedge relationship.

**Fair value hedge** - in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and, where the hedged item is measured at amortised cost, adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; or if the hedging instrument expires or is sold, terminated or exercised; or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

**Cash flow hedge** - in a cash flow hedge, the effective portion of the gain or loss on the hedging instrument is recognised in other comprehensive income and the ineffective portion in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity to profit or loss in the same periods in which the hedged forecast cash flows affect profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss is reclassified from equity to profit or loss when the hedged cash flows occur or, if the forecast transaction results in the recognition of a financial asset or financial liability, when the hedged forecast cash flows affect profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is reclassified from equity to profit or loss immediately.

**Hedge of net investment in a foreign operation** - in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised in other comprehensive income. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge. On disposal or partial disposal of a foreign operation, the amount accumulated in equity is reclassified from equity to profit or loss.

### 24. Share-based compensation

RBS Group operates a number of share-based compensation schemes under which it awards RBSG shares and share options to its employees. Such awards are generally subject to vesting conditions: conditions that vary the amount of cash or shares to which an employee is entitled. Vesting conditions include service conditions (requiring the employee to complete a specified period of service) and performance conditions (requiring the employee to complete a specified period of service and specified performance targets to be met). Other conditions to which an award is subject are non-vesting conditions (such as a requirement to save throughout the vesting period).

The cost of employee services received in exchange for an award of shares or share options granted is measured by reference to the fair value of the shares or share options on the date the award is granted and takes into account non-vesting conditions and market performance conditions (conditions related to the market price of RBSG shares): an award is treated as vesting irrespective of whether any market performance condition or non-vesting condition is met. The fair value of options granted is estimated using valuation techniques which incorporate exercise price, term, risk-free interest rates, the current share price and its expected volatility. The cost is expensed on a straight-line basis over the vesting period (the period during which all the specified vesting conditions must be satisfied) with a corresponding increase in equity in an equity-settled award, or a corresponding liability in a cash-settled award. The cost is adjusted for vesting conditions (other than market performance conditions) so as to reflect the number of shares or share options that actually vest.



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If an award is modified, the original cost continues to be recognised as if there had been no modification. Where modification increases the fair value of the award, this increase is recognised as an expense over the modified vesting period. A new award of shares or share options is treated as the modification of a cancelled award if, on the date the new award is granted, the RBS Group identifies them as replacing the cancelled award. The cancellation of an award through failure to meet non-vesting conditions triggers an immediate expense for any unrecognised element of the cost of an award.

### 25. Cash and cash equivalents

In the cash flow statement, cash and cash equivalents comprises cash and deposits with banks with an original maturity of less than three months together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

### 26. Shares in Group entities

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

### Critical accounting policies and key sources of estimation uncertainty

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's 'Conceptual Framework for Financial Reporting'. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

### Pensions

The Group operates a number of defined benefit pension schemes as described in Note 4 on the accounts. The assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit credit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any recognisable surplus or deficit of scheme assets over liabilities is recorded in the balance sheet as an asset (surplus) or liability (deficit).

In determining the value of scheme liabilities, financial and demographic assumptions are made including price inflation, pension increases, earnings growth and the longevity of scheme members. A range of assumptions could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the surplus or deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for the Group's pension schemes are set out in Note 4 on the accounts, together with sensitivities of the balance sheet and income statement to changes in those assumptions.

A pension asset of £214 million and a liability of £3,188 million were recognised on the balance sheet at 31 December 2013 (2012 - asset £144 million, liability £3,854 million; 2011 - asset £24 million, liability £2,188 million).

### Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as discussed in Accounting policy 6. The carrying value of goodwill as at 31 December 2013 was £10,130 million (2012 - £10,423 million; 2011 - £10,662 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions, such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash-generating units with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an orderly transaction between market participants.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to changes in assumptions is discussed in Note 18 on page 279.

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### Provisions for liabilities

As set out in Note 23, at 31 December 2013 the Group recognised provisions for liabilities in respect of Payment Protection Insurance, £926 million (2012 - £895 million; 2011 - £745 million), Interest Rate Hedging Products, £1,077 million (2012 - £676 million; 2011 - nil), LIBOR investigations, £416 million (2012 - £381 million; 2011 - nil) and other regulatory proceedings and litigation, £2,113 million (2012 - £284 million; 2011 - £195 million). Provisions are liabilities of uncertain timing or amount, and are recognised when there is a present obligation as a result of a past event, the outflow of economic benefit is probable and the outflow can be estimated reliably. Judgement is involved in determining whether an obligation exists, and in estimating the probability, timing and amount of any outflows. Where the Group can look to another party such as an insurer to pay some or all of the expenditure required to settle a provision, any reimbursement is recognised when, and only when, it is virtually certain that it will be received.

**Payment Protection Insurance** - the Group has established a provision for redress payable in respect of the mis-selling of Payment Protection Insurance policies. The provision is management's best estimate of the anticipated costs of redress and related administration expenses. The determination of appropriate assumptions to underpin the provision requires significant judgement by management. The principal assumptions underlying the provision together with sensitivities to changes in those assumptions are given in Note 23.

**Interest Rate Hedging Products** - the Group has agreed to a redress exercise and past business reviews in relation to the sale of Interest Rate Hedging Products to some small and medium sized businesses classified as retail clients. The ultimate cost of this exercise to the Group is uncertain. Estimating the liability depends on a number of assumptions. These assumptions and the sensitivity of the provision to changes in them are discussed in Note 23.

**Provisions for litigation** - the Group and members of the Group are party to legal proceedings in the United Kingdom, the United States and other jurisdictions, arising out of their normal business operations. The measurement and recognition of liabilities in respect of litigation involves a high degree of management judgement. Before the existence of a present obligation as the result of a past event can be confirmed, numerous facts may need to be established, involving extensive and time-consuming discovery, and novel or unsettled legal questions addressed. Once it is determined there is an obligation, assessing the probability of economic outflows and estimating the amount of any liability can be very difficult. In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Furthermore, for an individual matter, there can be a wide range of possible outcomes and often it is not practicable to quantify a range of such outcomes. The Group's outstanding litigation is periodically assessed in consultation with external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability. A detailed description of the Group's material legal proceedings and a discussion of the nature of the associated uncertainties are given in Note 31.

**Tax contingencies** - determining the Group's income tax charge and its provisions for income taxes necessarily involves a significant degree of estimation and judgement. The tax treatment of some transactions is uncertain and tax computations are yet to be agreed with the tax authorities in a number of jurisdictions. The Group recognises anticipated tax liabilities based on all available evidence and, where appropriate, in the light of external advice. Any difference between the final outcome and the amounts provided will affect current and deferred income tax assets and liabilities in the period when the matter is resolved.

### Deferred tax

The Group makes provision for deferred tax on temporary differences where tax recognition occurs at a different time from accounting recognition. Deferred tax assets of £3,435 million were recognised as at 31 December 2013 (2012 - £3,066 million; 2011 - £3,320 million).

The Group has recognised deferred tax assets in respect of losses, principally in the UK, and temporary differences. Deferred tax assets are recognised in respect of unused tax losses to the extent that it is probable that there will be future UK taxable profits against which the losses can be utilised. Business projections indicate that sufficient future taxable income will be available against which to offset these recognised deferred tax assets within eight years (2012 and 2011 - six years). Deferred tax assets of £2,723 million (2012 - £1,295 million; 2011 - £743 million) have not been recognised in respect of tax losses carried forward where the availability of future taxable profits is uncertain. Further details about the Group's deferred tax assets are given in Note 24.

### Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. Such objective evidence, indicative that a borrower's financial condition has deteriorated, can include for loans that are individually assessed: the non-payment of interest or principal; debt renegotiation; probable bankruptcy or liquidation; significant reduction in the value of any security; breach of limits or covenants; and deteriorating trading performance and, for collectively assessed portfolios: the borrowers' payment status and observable data about relevant macroeconomic measures.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2013, loans and advances to customers classified as loans and receivables totalled £363,555 million (2012 - £392,901 million; 2011 - £402,324 million) and customer loan impairment provisions amounted to £24,983 million (2012 - £20,693 million; 2011 - £18,469 million). Customer loan impairment provisions charged to profit or loss in 2013 amounted to £8,480 million (2012 - £5,270 million; 2011 - £6,969 million). These include loan impairment provisions in respect of loans to be transferred to RBS Capital Resolution Group. These loans are expected to be exited within three years and impairment provisions in respect of these loans have been reassessed in the light of this change in recovery strategy.

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

*Individual component* - all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

*Collective component* - this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collectively assessed provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). Collectively assessed provisions are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include mortgages, credit card receivables and other personal lending. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends. Latent loss provisions are held against estimated impairment losses in the performing portfolio that have yet to be identified as at the balance sheet date. To assess the latent loss within its portfolios, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

### Fair value - financial instruments

Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. Gains or losses arising from changes in the fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised.

Financial instruments measured at fair value include:

*Loans and advances (held-for-trading and designated as at fair value though profit or loss)* - principally comprise reverse repurchase agreements (reverse repos) and cash collateral.

*Debt securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale)* - debt securities include those issued by governments, municipal bodies, mortgage agencies and financial institutions as well as corporate bonds, debentures and residual interests in securitisations.

*Equity securities (held-for-trading, designated as at fair value though profit or loss and available-for-sale)* - comprise equity shares of companies or corporations both listed and unlisted.

*Deposits by banks and customer accounts (held-for-trading and designated as at fair value though profit or loss)* - deposits measured at fair value principally include repurchase agreements (repos) and cash collateral.

*Debt securities in issue (held-for-trading and designated as at fair value though profit or loss)* - principally comprise medium term notes.

*Short positions (held-for-trading)* - arise in dealing and market making activities where debt securities and equity shares are sold which the Group does not currently possess.

*Derivatives* - these include swaps (currency swaps, interest rate swaps, credit default swaps, total return swaps and equity and equity index swaps), forward foreign exchange contracts, forward rate agreements, futures (currency, interest rate and equity) and options (exchange-traded options on currencies, interest rates and equities and equity indices and OTC currency and equity options, interest rate caps and floors and swaptions).

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. It also uses the assumptions that market participants would use when pricing the asset or liability. In determining fair value the Group maximises the use of relevant observable inputs and minimises the use of unobservable inputs.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, it measures the fair value of a group of financial assets and financial liabilities on the basis of the price that it would receive to sell a net long position (i.e. an asset) for a particular risk exposure or to transfer a net short position (i.e. a liability) for a particular risk exposure in an orderly transaction at the measurement date under current market conditions.

Credit valuation adjustments are made when valuing derivative financial assets to incorporate counterparty credit risk. Adjustments are also made when valuing financial liabilities measured at fair value to reflect the Group's own credit standing.

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Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data. More details about the Group's valuation methodologies and the sensitivity to reasonably possible alternative assumptions of the fair value of financial instruments valued using techniques where at least one significant input is unobservable are given in Note 11 on pages 245 to 262.

### Accounting developments

#### International Financial Reporting Standards

A number of IFRSs and amendments to IFRS were in issue at 31 December 2013 that had effective dates of 1 January 2014 or later.

#### Effective for 2014

'Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)' adds application guidance to IAS 32 to address inconsistencies identified in applying some of the standard's criteria for offsetting financial assets and financial liabilities.

'Investment Entities (amendments to IFRS 10, IFRS 12 and IAS 27)' applies to investment entities; such entities should measure their subsidiaries (other than those that provide services related to the entity's investment activities) at fair value through profit or loss.

IFRIC 21 'Levies' provides guidance on accounting for levies payable to public authorities if certain conditions are met on a particular date.

IAS 36 'Recoverable Amount Disclosures for Non-Financial Assets (Amendments to IAS 36)' align IAS 36's disclosure requirements about recoverable amounts with IASB's original intentions.

IAS 39 'Novation of Derivatives and Continuation of Hedge Accounting (Amendments to IAS 39)' provides relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria.

The implementation of these requirements is not expected to have a material effect on the Group's financial statements.

#### Effective after 2014

IAS 19 'Defined Benefit Plans: Employee Contributions' was issued in November 2013. This amendment distinguishes the accounting for employee contributions that are related to service from those that are independent of service. It is effective for annual periods beginning on or after 1 July 2014.

Annual Improvements to IFRS 2010 - 2012 and 2011 - 2013 cycles were issued in December 2013. There are a number of minor changes to IFRS that will not have a material effect on the Group's financial statements. All amendments are effective for annual periods beginning on or after 1 July 2014.

In November 2009, the IASB issued IFRS 9 'Financial Instruments' simplifying the classification and measurement requirements in IAS 39 in respect of financial assets. The standard reduces the measurement categories for financial assets to two: fair value and amortised cost. A financial asset is classified on the basis of the entity's business model for managing the financial asset and the contractual cash flow characteristics

of the financial asset. Only assets with contractual terms that give rise to cash flows on specified dates that are solely payments of principal and interest on principal and which are held within a business model whose objective is to hold assets in order to collect contractual cash flows are classified as amortised cost. All other financial assets are measured at fair value. Changes in the value of financial assets measured at fair value are generally taken to profit or loss.

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

In November 2013, the IASB published IFRS 9 'Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)'. These amendments introduce a new hedge accounting model. The classification of hedges into fair value, cash flow and net investment hedges has been retained. The changes to the current hedge accounting framework include:

- Hedge effectiveness testing is prospective only based on the hedging objective.
- A risk component can be designated as the hedged item, for financial items and non-financial items, provided it is separately identifiable and reliably measureable.
- The time value of an option, the forward element of a forward contract and any foreign currency basis spread can be excluded from the designation of a financial instrument as the hedging instrument and accounted for as hedging costs.

The amendments also:

- revised IFRS 9 to allow an entity to elect to apply its requirement to present changes in the fair value of liabilities designated as at fair value through profit or loss attributable to own credit risk in other comprehensive income without applying the other requirements of the standard; otherwise all phases of IFRS 9 must be applied from the same effective date.
- removed from IFRS 9 the effective date of 1 January 2015.

At its February 2014 meeting the IASB tentatively agreed on 1 January 2018 as the effective date for IFRS 9.

IFRS 9 makes major changes to the framework for financial instrument accounting. The Group is assessing its effect which will depend on the results of IASB's reconsideration of classification and measurement and the final requirements for the impairment of financial assets expected to be published in 2014.

## Notes on the accounts

### 1 Net interest income

|                                        | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|----------------------------------------|------------|------------|------------|
| Loans and advances to customers        | 14,947     | 15,564     | 16,716     |
| Loans and advances to banks            | 478        | 515        | 561        |
| Debt securities                        | 978        | 1,477      | 1,833      |
| Interest receivable                    | 16,403     | 17,556     | 19,110     |
| Customer accounts: demand deposits     | 665        | 768        | 761        |
| Customer accounts: savings deposits    | 1,349      | 1,608      | 1,343      |
| Customer accounts: other time deposits | 706        | 837        | 830        |
| Deposits by banks                      | 333        | 489        | 646        |
| Debt securities in issue               | 1,105      | 1,780      | 3,036      |
| Subordinated liabilities               | 1,314      | 1,207      | 1,034      |
| Internal funding of trading businesses | 337        | 235        | 162        |
| Interest payable                       | 5,809      | 6,924      | 7,812      |
| Net interest income                    | 10,594     | 10,632     | 11,298     |

## Notes on the accounts

### 2 Non-interest income

|                                                                                                                                                                     | 2013<br>£m   | 2012<br>£m   | 2011<br>£m     |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|----------------|
| Fees and commissions receivable                                                                                                                                     |              |              |                |
| Payment services                                                                                                                                                    | 1,421        | 1,301        | 1,388          |
| Credit and debit card fees                                                                                                                                          | 1,074        | 1,078        | 1,088          |
| Lending (credit facilities)                                                                                                                                         | 1,365        | 1,437        | 1,580          |
| Brokerage                                                                                                                                                           | 471          | 519          | 587            |
| Trade finance                                                                                                                                                       | 274          | 227          | 281            |
| Investment management                                                                                                                                               | 401          | 421          | 434            |
| Other                                                                                                                                                               | 374          | 575          | 540            |
|                                                                                                                                                                     | <b>5,380</b> | <b>5,558</b> | <b>5,898</b>   |
| Fees and commissions payable                                                                                                                                        | <b>(911)</b> | <b>(963)</b> | <b>(1,047)</b> |
| Income from trading activities (1)                                                                                                                                  |              |              |                |
| Foreign exchange                                                                                                                                                    | 938          | 632          | 944            |
| Interest rate                                                                                                                                                       | 570          | 1,777        | 797            |
| Credit                                                                                                                                                              | 1,296        | 797          | (219)          |
| Changes in fair value of own debt and derivative liabilities attributable to own credit                                                                             |              |              |                |
| - debt securities in issue                                                                                                                                          | 133          | (1,471)      | 225            |
| - derivative liabilities                                                                                                                                            | (84)         | (302)        | 66             |
| Equities                                                                                                                                                            | 111          | 78           | 263            |
| Commodities and other                                                                                                                                               | 10           | —            | (62)           |
|                                                                                                                                                                     | <b>2,974</b> | <b>1,511</b> | <b>2,014</b>   |
| Gain on redemption of own debt (2)                                                                                                                                  | <b>162</b>   | <b>454</b>   | <b>255</b>     |
| Other operating income                                                                                                                                              |              |              |                |
| Operating lease and other rental income                                                                                                                             | 483          | 876          | 1,306          |
| Changes in the fair value of own debt designated as at fair value through profit or loss attributable to own credit risk (3)                                        |              |              |                |
| - debt securities in issue                                                                                                                                          | (35)         | (1,998)      | 410            |
| - subordinated liabilities                                                                                                                                          | (39)         | (133)        | 96             |
| Other changes in the fair value of securities and other financial assets and liabilities designated as at fair value through profit or loss and related derivatives | (44)         | 69           | 187            |
| Changes in the fair value of investment properties                                                                                                                  | (281)        | (148)        | (139)          |
| Profit on sale of securities                                                                                                                                        | 1,035        | 1,803        | 867            |
| Profit on sale of property, plant and equipment                                                                                                                     | 45           | 21           | 11             |
| Profit/(loss) on sale of subsidiaries and associates                                                                                                                | 179          | 150          | (67)           |
| Dividend income (4)                                                                                                                                                 | 83           | 234          | 216            |
| Share of profits of associated entities                                                                                                                             | (1)          | (5)          | 21             |
| Other income (5)                                                                                                                                                    | 151          | 427          | 480            |
|                                                                                                                                                                     | <b>1,576</b> | <b>1,296</b> | <b>3,388</b>   |

#### Notes:

- (1) The analysis of income from trading activities is based on how the business is organised and the underlying risks managed. Income from trading activities comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs. The types of instruments include:
- Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
  - Interest rate: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
  - Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
  - Equities: equities, equity derivatives and related hedges and funding.
  - Commodities: commodity contracts and related hedges and funding.
- (2) In January 2013, the Group redeemed certain senior unsecured securities for cash resulting in losses of £51 million. In June 2013, the Group redeemed certain mortgage backed debt securities in exchange for cash resulting in gains totalling £242 million. In December 2013 the group redeemed £987 million in senior unsecured debt resulting in a loss of £29 million. In March 2012 and September 2012, the Group redeemed certain notes resulting in net gains totalling £454 million being credited to profit or loss. In June 2011, the Group redeemed certain mortgage backed debt securities in exchange for cash, resulting in gains totalling £255 million being credited to profit or loss.
- (3) Measured as the charge in fair value from movements in the year in the credit risk premium payable by the Group.
- (4) Dividend income includes nil (2012 - £179 million; 2011 - £165 million) arising from investments in fellow subsidiaries of the RBS Group and consequently subject to the RBS Group's capital management policy (see Note 30).
- (5) Includes income from activities other than banking.



## Notes on the accounts

### 3 Operating expenses

|                                                                  | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    |
|------------------------------------------------------------------|---------------|---------------|---------------|
| Wages, salaries and other staff costs                            | 5,908         | 6,438         | 6,291         |
| Bonus tax                                                        | —             | —             | 78            |
| Social security costs                                            | 478           | 531           | 548           |
| Share-based compensation                                         | 49            | 126           | 197           |
| - defined benefit schemes (see Note 4)                           | 513           | 512           | 531           |
| - curtailment and settlement gains (see Note 4)                  | (3)           | (38)          | —             |
| - defined contribution schemes                                   | 61            | 16            | 69            |
| Staff costs                                                      | 7,006         | 7,585         | 7,714         |
| Premises and equipment                                           | 2,304         | 2,080         | 2,083         |
| Other administrative expenses (1)                                | 7,082         | 5,468         | 4,229         |
| Property, plant and equipment (see Note 19)                      | 840           | 1,064         | 1,197         |
| Intangible assets (see Note 18)                                  | 432           | 550           | 393           |
| Depreciation and amortisation                                    | 1,272         | 1,614         | 1,590         |
| Write-down of goodwill and other intangible assets (see Note 18) | 423           | 51            | 80            |
|                                                                  | <b>18,087</b> | <b>16,798</b> | <b>15,696</b> |

Note:

(1) Includes Bank levy, Payment Protection Insurance costs, Interest Rate Hedging Products redress and related costs and regulatory and legal actions, which are discussed in more detail below.

#### Bank levy

The UK bank levy was charged at a rate of 0.13% on chargeable liabilities in excess of £20 billion, and for the RBS Group amounted to £200 million for 2013 (2012 - 0.088%, £175 million; 2011: average 0.075%, £300 million).

#### Payment Protection Insurance (PPI)

To reflect current experience of PPI complaints received, the Group increased its provision for PPI by £900 million in 2013 (2012 - £1,110 million), bringing the cumulative charge taken to £3.1 billion, of which £2.2 billion (70%) in redress had been paid by 31 December 2013. Of the £3.1 billion cumulative charge, £2.8 billion relates to redress and £0.3 billion to administrative expenses. The eventual cost is dependent upon complaint volumes, uphold rates and average redress costs.

Assumptions relating to these are inherently uncertain and the ultimate financial impact may be different from the amount provided. The Group will continue to monitor the position closely and refresh its assumptions as more information becomes available.

#### Interest Rate Hedging Products redress and related costs

Following an industry-wide review conducted in conjunction with the Financial Services Authority (now being dealt with by the Financial Conduct Authority (FCA)), a charge of £700 million has been booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses, classified as retail clients under FSA rules. Of the £700 million charge, £575 million relates to redress and the cost of closing out hedging positions, and £125 million to administrative expenses. The estimate for administrative costs was increased by £50 million in the first half of 2013 following development of the plan for administering this process in accordance with FSA guidelines.

The provision was further increased in Q4 2013 by £500 million, reflecting both higher volumes and anticipated redress payments, recalibration of our methodology based on experience during the second half of 2013 and additional administration charges. The cumulative charge for IRHP is £1.3 billion, of which £1.0 billion relates to redress and £0.3 billion relates to administrative expenses. Customers may also be entitled to be compensated for any consequential losses they may have suffered. The Group is not able to measure reliably any liability it may have and has accordingly not made any provision.

The Group expects to complete its review of sales of IRHP and provide basic redress to all customers who are entitled to it by the end of 2014. On 23 October 2013, the Group announced that it would split redress payments for all customers who may have been mis-sold IRHP. Customers will receive redress monies without having to wait for the assessment of any additional consequential loss claims which are outside the allowance for such claims included in the 8% interest on redress due.

The Group continues to monitor the level of provision given the uncertainties over the number of transactions that will qualify for redress and the nature and cost of that redress.

#### Regulatory and legal actions

The Group is party to certain legal proceedings and regulatory investigations and continues to co-operate with a number of regulators. All such matters are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of the Group incurring a liability and to evaluate the extent to which a reliable estimate of any liability can be made. A charge of £2,394 million was booked in 2013, primarily in respect of matters related to mortgage-backed securities and securities related litigation following recent third party litigation settlements and regulatory decisions.

## Notes on the accounts

### 3 Operating expenses continued

Integration costs included in operating expenses comprise expenditure incurred in respect of cost reduction and revenue enhancement programmes connected with acquisitions made by the Group.

|                               | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------|------------|------------|------------|
| Staff costs                   | —          | —          | 30         |
| Premises and equipment        | 1          | 3          | 20         |
| Other administrative expenses | 1          | 2          | 45         |
| Depreciation and amortisation | —          | —          | 10         |
|                               | <b>2</b>   | <b>5</b>   | <b>105</b> |

Restructuring costs included in operating expenses comprise:

|                               | 2013<br>£m | 2012<br>£m   | 2011<br>£m |
|-------------------------------|------------|--------------|------------|
| Staff costs                   | 178        | 575          | 297        |
| Premises and equipment        | 96         | 119          | 136        |
| Other administrative expenses | 141        | 214          | 209        |
| Depreciation and amortisation | 6          | 142          | —          |
|                               | <b>421</b> | <b>1,050</b> | <b>642</b> |

Divestment costs included in operating expenses comprise:

|                               | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------|------------|------------|------------|
| Staff costs                   | 86         | 111        | 84         |
| Premises and equipment        | 2          | (2)        | 11         |
| Other administrative expenses | 77         | 62         | 51         |
|                               | <b>165</b> | <b>171</b> | <b>146</b> |

The average number of persons employed, rounded to the nearest hundred, by the Group during the year, excluding temporary staff, was 107,100 (2012 - 108,600; 2011 - 111,500). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

|                        | Group          |                |                |
|------------------------|----------------|----------------|----------------|
|                        | 2013           | 2012           | 2011           |
| UK Retail              | 25,300         | 27,500         | 29,200         |
| UK Corporate           | 13,300         | 13,000         | 13,400         |
| Wealth                 | 4,700          | 4,800          | 5,200          |
| International Banking  | 3,800          | 3,800          | 3,400          |
| Ulster Bank            | 4,700          | 4,400          | 4,400          |
| US Retail & Commercial | 18,700         | 19,200         | 20,000         |
| Retail & Commercial    | 70,500         | 72,700         | 75,600         |
| Markets                | 9,300          | 9,200          | 9,700          |
| Central items          | 6,700          | 5,700          | 4,900          |
| Core                   | 86,500         | 87,600         | 90,200         |
| Non-Core               | 900            | 1,500          | 1,700          |
| Business Services      | 18,700         | 19,000         | 19,000         |
| Total                  | <b>106,100</b> | <b>108,100</b> | <b>110,900</b> |
| UK                     | 69,200         | 71,200         | 76,100         |
| USA                    | 21,300         | 21,900         | 22,900         |
| Europe                 | 8,200          | 8,100          | 5,300          |
| Rest of the World      | 7,400          | 6,900          | 6,600          |
| Total                  | <b>106,100</b> | <b>108,100</b> | <b>110,900</b> |



## Notes on the accounts

### 3 Operating expenses continued

#### Share-based payments

As described in the Remuneration report in the RBS Group Annual Report and Accounts 2013, the RBS Group grants share-based awards to employees principally on the following bases:

| Award plan                  | Eligible employees                                                  | Nature of award (1)                              | Vesting conditions (2)                                                                                 | Settlement   |
|-----------------------------|---------------------------------------------------------------------|--------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------|
| Sharesave                   | UK, Republic of Ireland, Channel Islands, Gibraltar and Isle of Man | Option to buy shares under employee savings plan | Continuing employment or leavers in certain circumstances                                              | 2014 to 2019 |
| Deferred performance awards | All                                                                 | Awards of ordinary shares                        | Continuing employment or leavers in certain circumstances                                              | 2014 to 2016 |
| Restricted share awards     | Senior employees                                                    | Awards of conditional shares                     | Continuing employment or leavers in certain circumstances and/or achievement of performance conditions | 2014 to 2015 |
| Long-term incentives (3)    | Senior employees                                                    | Awards of conditional shares or share options    | Continuing employment or leavers in certain circumstances and/or achievement of performance conditions | 2014 to 2019 |

Notes:  
(1) Awards are equity-settled unless international comparability is better served by cash-settled awards.  
(2) All awards have vesting conditions and therefore some may not vest.  
(3) Long-term incentives include the Executive Share Option Plan, the Long-Term Incentive Plan and the Medium-Term Performance Plan.  
(4) The strike price of options and the fair value on granting awards of fully paid shares is the average market price over the five trading days preceding grant date.

#### Sharesave

|                | 2013                        |                                  | 2012                        |                                  | 2011                        |                                  |
|----------------|-----------------------------|----------------------------------|-----------------------------|----------------------------------|-----------------------------|----------------------------------|
|                | Average exercise price<br>£ | Shares under option<br>(million) | Average exercise price<br>£ | Shares under option<br>(million) | Average exercise price<br>£ | Shares under option<br>(million) |
| At 1 January   | 2.86                        | 57                               | 3.36                        | 64                               | 4.88                        | 101                              |
| Granted        | 2.96                        | 13                               | 2.49                        | 14                               | 2.33                        | 30                               |
| Exercised      | 2.36                        | —                                | 2.37                        | —                                | 3.80                        | (1)                              |
| Cancelled      | 3.38                        | (8)                              | 3.76                        | (21)                             | 4.11                        | (66)                             |
| At 31 December | 2.90                        | 62                               | 2.86                        | 57                               | 3.36                        | 64                               |

Options are exercisable within six months of vesting; 1.3 million were exercisable at 31 December 2013 (2012 - 0.2 million; 2011 - 0.3 million). The weighted average share price at the date of exercise of options was £3.36 (2012 - £2.78; 2011 - £4.21). At 31 December 2013, exercise prices ranged from £2.33 to £39.27 and the average contractual life was 3.5 years (2012 - £2.33 to £39.27 and 3.9 years; 2011 - £2.33 to £39.27 and 3.7 years). The fair value of options granted in 2013 was £25 million (2012 - £28 million; 2011 - £43 million).

#### Deferred performance awards

|                | 2013                 |                             | 2012                 |                             | 2011                 |                             |
|----------------|----------------------|-----------------------------|----------------------|-----------------------------|----------------------|-----------------------------|
|                | Value at grant<br>£m | Shares awarded<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) |
| At 1 January   | 261                  | 73                          | 756                  | 191                         | 1,009                | 267                         |
| Granted        | 113                  | 36                          | 141                  | 50                          | 258                  | 58                          |
| Forfeited      | (48)                 | (14)                        | (98)                 | (25)                        | (47)                 | (13)                        |
| Vested         | (146)                | (40)                        | (538)                | (143)                       | (464)                | (121)                       |
| At 31 December | 180                  | 55                          | 261                  | 73                          | 756                  | 191                         |

The awards granted in 2013 vest evenly over the following three anniversaries.

## Notes on the accounts

### 3 Operating expenses continued

#### Restricted share awards

|                | 2013                 |                             | 2012                 |                             | 2011                 |                             |
|----------------|----------------------|-----------------------------|----------------------|-----------------------------|----------------------|-----------------------------|
|                | Value at grant<br>£m | Shares awarded<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) |
| At 1 January   | 16                   | 3                           | 100                  | 30                          | 110                  | 34                          |
| Exercised      | (9)                  | (2)                         | (49)                 | (17)                        | (6)                  | (3)                         |
| Lapsed         | (7)                  | (1)                         | (35)                 | (10)                        | (4)                  | (1)                         |
| At 31 December | —                    | —                           | 16                   | 3                           | 100                  | 30                          |

The market value of awards exercised in 2013 was £6 million (2012 - £45 million; 2011 - £11 million).

#### Long-term incentives

|                | 2013                 |                             |                                  | 2012                 |                             |                                  | 2011                 |                             |                                  |
|----------------|----------------------|-----------------------------|----------------------------------|----------------------|-----------------------------|----------------------------------|----------------------|-----------------------------|----------------------------------|
|                | Value at grant<br>£m | Shares awarded<br>(million) | Options over shares<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) | Options over shares<br>(million) | Value at grant<br>£m | Shares awarded<br>(million) | Options over shares<br>(million) |
| At 1 January   | 375                  | 98                          | 20                               | 345                  | 58                          | 37                               | 219                  | 25                          | 38                               |
| Granted        | 109                  | 35                          | —                                | 157                  | 59                          | —                                | 154                  | 37                          | 1                                |
| Exercised      | (51)                 | (11)                        | (3)                              | (15)                 | (4)                         | (1)                              | (6)                  | (1)                         | —                                |
| Lapsed         | (113)                | (28)                        | (4)                              | (112)                | (15)                        | (16)                             | (22)                 | (3)                         | (2)                              |
| At 31 December | 320                  | 94                          | 13                               | 375                  | 98                          | 20                               | 345                  | 58                          | 37                               |

The market value of awards exercised in 2013 was £37 million (2012 - £10 million; 2011 - £5 million). There are vested options over 13 million shares exercisable up to 2019 (2012 - 18 million shares up to 2019; 2011 - 5 million shares up to 2019).

At 31 December 2013, a provision of £1 million had been made in respect of 0.1 million options over shares that may be cash-settled (2012 - £1 million in respect of 0.1 million share awards and 0.3 million options over shares; 2011 - £3 million in respect of 0.4 million share awards and 1.4 million options over shares).

The fair value of options granted in 2013 was determined using a pricing model that included: expected volatility of shares determined at the grant date based on historic volatility over a period of up to seven years; expected option lives that equal the vesting period; no dividends on equity shares; and a risk-free interest rate determined from the UK gilt rates with terms matching the expected lives of the options.

## Notes on the accounts

### 4 Pensions

The Group sponsors a number of pension schemes in the UK and overseas whose assets are independent of the Group's finances.

The Royal Bank of Scotland Group Pension Fund (the "Main scheme") operates under UK trust law and is managed and administered on behalf of its members in accordance with the terms of the trust deed, the scheme rules and UK legislation (principally the Pension Schemes Act 1993, the Pensions Act 1995 and the Pensions Act 2004). Under UK legislation a defined benefit pension scheme is required to meet the statutory funding objective of having sufficient and appropriate assets to cover its cover its liabilities. Pension fund trustees are required to: prepare a statement of funding principles; obtain regular actuarial valuations and reports; put in place a recovery plan addressing any funding shortfall; and send regular summary funding statements to members of the scheme.

The Main scheme corporate trustee is RBS Pension Trustee Limited (RBSPT), a wholly owned subsidiary of National Westminster Bank Plc. RBSPT is the legal owner of the Main scheme assets which are held separately from the assets of the Group. The Board of RBSPT comprises four trustee directors nominated by members selected from eligible active staff and pensioner members who apply and six appointed by the Group. The Board is responsible for operating the scheme in line with its formal rules and pensions law. It has a duty to act in the best interests of all scheme members, including pensioners and those who are no longer employed by the Group, but who still have benefits in the scheme.

Similar governance principles apply to the Group's other pension schemes, although different legislative frameworks apply to the Group's overseas schemes.

Interim valuations of the Group's schemes under IAS 19 'Employee Benefits' were prepared at 31 December with the support of independent actuaries, using the following assumptions:

| Principal actuarial assumptions (weighted average) | 2013<br>% | 2012*<br>% | 2011*<br>% |
|----------------------------------------------------|-----------|------------|------------|
| Discount rate                                      | 4.5       | 4.4        | 5.0        |
| Expected return on plan assets                     | 4.5       | 4.4        | 5.0        |
| Rate of increase in salaries                       | 1.8       | 1.7        | 1.8        |
| Rate of increase in pensions in payment            | 2.9       | 2.6        | 2.8        |
| Inflation assumption                               | 3.2       | 2.8        | 2.9        |

\*Restated

The Main scheme, accounting for 86% (2012 - 85%; 2011 - 88%) of the Group's retirement benefit obligations, was closed to new entrants in 2006. Since 2009, pensionable salary increases in the Main scheme and certain other UK and Irish schemes have been limited to 2% per annum or CPI inflation if lower. Also, with effect from 1 October 2012, the normal pension age for future benefits was increased to 65 unless members elected to make a contribution to maintain a normal pension age of 60.

The Group's defined benefit schemes generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees making additional contributions can secure additional benefits.

Since October 2006, new UK entrants may join The Royal Bank of Scotland Retirement Savings Plan, a defined contribution pension scheme.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of eligible employees. The amounts are not material.

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

## Notes on the accounts

### 4 Pensions continued

#### Discount rate

The Group discounts its defined benefit pension obligations at discount rates determined by reference to the yield on 'high quality' corporate bonds.

The sterling yield curve (applied to 92% of the Group's defined benefit obligations) is constructed by reference to yields on 'AA' corporate bonds from which a single discount rate is derived based on a cash flow profile similar in structure and duration to the pension obligations. Significant judgement is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The criteria include issue size, quality of pricing and the exclusion of outliers. Judgement is also required in determining the shape of the yield curve at long durations: a constant credit spread relative to gilts is assumed.

Prior to 2012 the discount rate was determined by reference to the upper quartile yield on the iBoxx over 15 year sterling corporate bond index, less a margin determined by reference to the shape of the yield curve and the spread of yields among the index's constituents.

Discount rates for other currencies are derived using a variety of methodologies. In the case of US dollar defined benefit obligations, a matching portfolio of high-quality 'AA' corporate bonds is used for the first 30 years' cash flows; cash flows beyond 30 years are discounted using a yield curve determined in a similar way to the UK. For euro defined benefit obligations, a similar approach to the UK has been used at 31 December 2013. However, at longer durations, rates are derived by extrapolating yields on 'A' and 'AAA' corporate bonds to derive equivalent 'AA' yields. Prior to 2012, extrapolation was not used at longer durations and different criteria were used to determine the reference pool of 'AA' bonds.

| Major classes of plan assets as a percentage of total plan assets | 2013<br>%    | 2012<br>%    | 2011<br>%    |
|-------------------------------------------------------------------|--------------|--------------|--------------|
| <b>Quoted assets</b>                                              |              |              |              |
| Quoted equities                                                   |              |              |              |
| - Consumer industry                                               | 4.3          | 4.4          | 4.9          |
| - Manufacturing industry                                          | 4.1          | 6.0          | 5.5          |
| - Energy and utilities                                            | 3.6          | 4.4          | 2.6          |
| - Financial institutions                                          | 3.9          | 4.4          | 3.8          |
| - Technology and telecommunications                               | 4.7          | 5.3          | 4.9          |
| - Other                                                           | 3.7          | 0.5          | 1.6          |
| Private equity                                                    | 4.4          | 4.7          | 4.9          |
| Index-linked bonds                                                | 28.3         | 28.7         | 24.3         |
| Government fixed interest bonds                                   | 2.2          | 2.9          | 2.8          |
| Corporate and other bonds                                         | 19.6         | 19.5         | 21.5         |
| <b>Unquoted assets</b>                                            |              |              |              |
| Corporate and other bonds                                         | 1.9          | 1.5          | 0.7          |
| Hedge funds                                                       | 5.1          | 2.5          | 2.4          |
| Real estate                                                       | 4.0          | 4.2          | 3.6          |
| Derivatives                                                       | 2.8          | 2.0          | 2.1          |
| Cash and other assets                                             | 7.1          | 9.0          | 13.7         |
| Equity exposure of equity futures                                 | 8.0          | 8.4          | 15.7         |
| Cash exposure of equity futures                                   | (7.7)        | (8.4)        | (15.0)       |
|                                                                   | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> |

The assets of the Main scheme, which represent 85% of plan assets at 31 December 2013 (2012 - 85%; 2011 - 89%), are invested in a diversified portfolio of quoted and private equity, government and corporate fixed-interest and index-linked bonds, and other assets including property and hedge funds.

The Main scheme also employs derivative instruments, where appropriate, to achieve a desired asset class exposure or to match assets more closely to liabilities. The value of assets shown reflects the actual physical assets held by the scheme, with any derivative holdings valued on a mark-to-market basis.

## Notes on the accounts

### 4 Pensions continued

The Main scheme's holdings of derivative instruments are summarised in the table below:

|                              | 2013                      |              |                   | 2012                      |              |                   | 2011                      |              |                   |
|------------------------------|---------------------------|--------------|-------------------|---------------------------|--------------|-------------------|---------------------------|--------------|-------------------|
|                              | Notional<br>amounts<br>£m | Fair value   |                   | Notional<br>amounts<br>£m | Fair value   |                   | Notional<br>amounts<br>£m | Fair value   |                   |
|                              |                           | Assets<br>£m | Liabilities<br>£m |                           | Assets<br>£m | Liabilities<br>£m |                           | Assets<br>£m | Liabilities<br>£m |
| Inflation rate swaps         | 6,273                     | 258          | 141               | 5,474                     | 20           | 335               | 2,585                     | 67           | 178               |
| Interest rate swaps          | 22,108                    | 3,283        | 2,867             | 19,304                    | 3,424        | 2,811             | 15,149                    | 2,232        | 1,864             |
| Total return swaps           | 187                       | 1            | —                 | 515                       | 6            | —                 | 2,085                     | 169          | —                 |
| Currency swaps               | 2,196                     | 813          | 720               | 2,539                     | 326          | 259               | 2,861                     | 116          | 117               |
| Credit default swaps         | 900                       | 13           | 16                | 709                       | 11           | 12                | 238                       | 6            | —                 |
| Equity and bond futures      | 1,904                     | 71           | 2                 | 2,109                     | 16           | 17                | 3,745                     | 80           | 10                |
| Currency forwards            | 9,182                     | 66           | —                 | 8,551                     | 41           | —                 | 2,078                     | 8            | —                 |
| Equity and bond call options | 4,102                     | 108          | 63                | 963                       | 94           | —                 | 814                       | 67           | 4                 |
| Equity and bond put options  | 4,071                     | 11           | 90                | 963                       | 13           | 31                | 665                       | 11           | —                 |

Swaps are part of the management of the inflation and interest rate sensitivity of the Main scheme liabilities. They have been executed at prevailing market rates and within standard market bid/offer spreads. The majority of swaps are with The Royal Bank of Scotland plc and National Westminster Bank Plc (the "banks"). At 31 December 2013, the gross notional value of the swaps was £31,664 million (2012 - £28,541 million; 2011 - £22,918 million) and had a net positive fair value of £624 million (2012 - £370 million positive; 2011 - £431 million positive) to the scheme.

Collateral is required on all swap transactions with those between the banks and the Main scheme on terms that do not allow the banks to re-hypothecate. The banks had delivered £633 million of collateral at 31 December 2013 (2012 - £521 million; 2011 - £375 million).

Ordinary shares of the holding company with a fair value of £4 million (2012 - £4 million; 2011 - £3 million) are held by the Group's Main scheme which also holds other financial instruments issued by the Group with a value of £416 million (2012 - £610 million; 2011 - £424 million).

### Post-retirement mortality assumptions (Main scheme)

|                                                                     | 2013 | 2012 | 2011 |
|---------------------------------------------------------------------|------|------|------|
| Longevity at age 60 for current pensioners (years)                  |      |      |      |
| Males                                                               | 27.6 | 27.3 | 27.2 |
| Females                                                             | 29.5 | 29.2 | 29.1 |
| Longevity at age 60 for future pensioners currently aged 40 (years) |      |      |      |
| Males                                                               | 28.6 | 29.4 | 29.3 |
| Females                                                             | 30.8 | 31.0 | 30.9 |

## Notes on the accounts

### 4 Pensions continued

|                                                                        | Fair value<br>of plan<br>assets<br>£m | Present value<br>of defined<br>benefit<br>obligations<br>£m | Net pension<br>deficit<br>£m |
|------------------------------------------------------------------------|---------------------------------------|-------------------------------------------------------------|------------------------------|
| <b>Changes in value of net pension deficit*</b>                        |                                       |                                                             |                              |
| At 1 January 2012                                                      | 23,830                                | 25,994                                                      | 2,164                        |
| Currency translation and other adjustments                             | (52)                                  | (65)                                                        | (13)                         |
| <b>Income statement</b>                                                |                                       |                                                             |                              |
| Expected return                                                        | 1,186                                 | —                                                           | (1,186)                      |
| Interest cost                                                          | —                                     | 1,294                                                       | 1,294                        |
| Current service cost                                                   | —                                     | 353                                                         | 353                          |
| Less: direct contributions from other scheme members                   | —                                     | (31)                                                        | (31)                         |
| Past service cost                                                      | —                                     | 82                                                          | 82                           |
| Gains on curtailments and settlements                                  | —                                     | (38)                                                        | (38)                         |
|                                                                        | 1,186                                 | 1,660                                                       | 474                          |
| <b>Statement of comprehensive income</b>                               |                                       |                                                             |                              |
| - Experience gains and losses                                          | 476                                   | 202                                                         | (274)                        |
| - Actuarial gains and losses due to changes in financial assumptions   | —                                     | 2,370                                                       | 2,370                        |
| - Actuarial gains and losses due to changes in demographic assumptions | —                                     | 34                                                          | 34                           |
|                                                                        | 476                                   | 2,606                                                       | 2,130                        |
| Transfers from fellow subsidiaries                                     | 1,009                                 | 852                                                         | (157)                        |
| Contributions by employer                                              | 888                                   | —                                                           | (888)                        |
| Contributions by plan participants and other scheme members            | 42                                    | 42                                                          | —                            |
| Benefits paid                                                          | (897)                                 | (897)                                                       | —                            |
| Assets and liabilities distributed on settlements                      | (123)                                 | (123)                                                       | —                            |
| At 1 January 2013                                                      | 26,359                                | 30,069                                                      | 3,710                        |
| Currency translation and other adjustments                             | (8)                                   | 2                                                           | 10                           |
| <b>Income statement</b>                                                |                                       |                                                             |                              |
| Expected return                                                        | 1,173                                 | —                                                           | (1,173)                      |
| Interest cost                                                          | —                                     | 1,314                                                       | 1,314                        |
| Current service cost                                                   | —                                     | 376                                                         | 376                          |
| Less: direct contributions from other scheme members                   | —                                     | (5)                                                         | (5)                          |
| Past service cost                                                      | —                                     | 1                                                           | 1                            |
| Gains on curtailments and settlements                                  | —                                     | (3)                                                         | (3)                          |
|                                                                        | 1,173                                 | 1,683                                                       | 510                          |
| <b>Statement of comprehensive income</b>                               |                                       |                                                             |                              |
| - Experience gains and losses                                          | 1,097                                 | (177)                                                       | (1,274)                      |
| - Actuarial gains and losses due to changes in financial assumptions   | —                                     | 593                                                         | 593                          |
| - Actuarial gains and losses due to changes in demographic assumptions | —                                     | 238                                                         | 238                          |
|                                                                        | 1,097                                 | 654                                                         | (443)                        |
| Transfers from fellow subsidiaries                                     | —                                     | 4                                                           | 4                            |
| Contributions by employer                                              | 817                                   | —                                                           | (817)                        |
| Contributions by plan participants and other scheme members            | 14                                    | 14                                                          | —                            |
| Benefits paid                                                          | (981)                                 | (981)                                                       | —                            |
| At 31 December 2013                                                    | 28,471                                | 31,445                                                      | 2,974                        |

\*Restated

|                                                                                                      | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|------------------------------------------------------------------------------------------------------|------------|------------|------------|
| <b>Net pension deficit comprises</b>                                                                 |            |            |            |
| Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 20) | (214)      | (144)      | (24)       |
| Net liabilities of schemes in deficit                                                                | 3,188      | 3,854      | 2,188      |
|                                                                                                      | 2,974      | 3,710      | 2,164      |

## Notes on the accounts

### 4 Pensions continued

Curtailment gains of £3 million were recognised in 2013 arising from changes to pension benefits in a subsidiary's scheme (2012 - £9 million; 2011 - nil). No settlement gains were recognised in 2013 in respect of subsidiaries' schemes (2012 - £29 million; 2011 - nil).

The weighted average duration of the Main Scheme's defined benefit obligation at 31 December 2013 is 18.0 years (2012 - 19.2 years; 2011 - 18.2 years).

RBS Group and the Trustees of the Main scheme agreed the funding valuation as at 31 March 2010 in 2011. It showed that the value of liabilities exceeded the value of assets by £3.5 billion as at 31 March 2010, a ratio of assets to liabilities of 84%. In order to eliminate this deficit, RBS Group agreed to pay additional contributions each year over the period 2011 to 2018.

The defined benefit obligation is attributable to the different classes of scheme members in the following proportions (Main scheme):

|           | 2013<br>% | 2012<br>% | 2011<br>% |
|-----------|-----------|-----------|-----------|
| Active    | 19.5      | 23.8      | 24.8      |
| Deferred  | 38.4      | 32.4      | 30.9      |
| Pensioner | 42.1      | 43.8      | 44.3      |
|           | 100.0     | 100.0     | 100.0     |

### History of defined benefit schemes

|                                               | 2013<br>£m | 2012*<br>£m | 2011*<br>£m | 2010*<br>£m | 2009*<br>£m |
|-----------------------------------------------|------------|-------------|-------------|-------------|-------------|
| Fair value of plan assets                     | 28,471     | 26,359      | 23,830      | 21,687      | 18,805      |
| Present value of defined benefit obligations  | 31,445     | 30,069      | 25,994      | 23,877      | 21,399      |
| Net deficit                                   | 2,974      | 3,710       | 2,164       | 2,190       | 2,594       |
| Experience gains/(losses) on plan liabilities | 177        | (202)       | (224)       | (851)       | 139         |
| Experience gains on plan assets               | 1,097      | 476         | 812         | 1,931       | 1,251       |
| Actual return on pension schemes assets       | 2,270      | 1,662       | 1,973       | 3,000       | 2,288       |
| Actual return on pension schemes assets - %   | 8.6%       | 7.0%        | 9.1%        | 16.0%       | 13.7%       |

\*Restated

The table below sets out the sensitivities of the pension cost for the year and the present value of defined benefit obligations at 31 December to a change in the principal actuarial assumptions:

|                                                          | (Decrease)/increase in pension cost for year |             |             | (Decrease)/increase in obligation at 31 December |             |            |
|----------------------------------------------------------|----------------------------------------------|-------------|-------------|--------------------------------------------------|-------------|------------|
|                                                          | 2013<br>£m                                   | 2012*<br>£m | 2011*<br>£m | 2013<br>£m                                       | 2012*<br>£m | 2011<br>£m |
| 0.25% increase in the discount rate                      | (80)                                         | (80)        | (75)        | (1,379)                                          | (1,392)     | (1,137)    |
| 0.25% increase in inflation                              | 58                                           | 66          | 65          | 1,000                                            | 1,129       | 997        |
| 0.25% additional rate of increase in pensions in payment | 48                                           | 45          | 42          | 844                                              | 782         | 671        |
| 0.25% additional rate of increase in deferred pensions   | 21                                           | 23          | 23          | 383                                              | 342         | 304        |
| 0.25% additional rate of increase in salaries            | 12                                           | 9           | 9           | 110                                              | 125         | 76         |
| Longevity increase of one year                           | 39                                           | 38          | 40          | 801                                              | 727         | 653        |

\*Restated

Pension costs and liabilities are calculated on the central assumptions and under the relevant sensitivity scenarios. The sensitivity to pension costs/liabilities is the difference between these calculations.

## Notes on the accounts

### 5 Auditor's remuneration

Amounts paid to the Group's auditors for statutory audit and other services are set out below:

|                                                                                | Group |      |
|--------------------------------------------------------------------------------|-------|------|
|                                                                                | 2013  | 2012 |
|                                                                                | £m    | £m   |
| Fees payable for the audit of the Group's annual accounts                      | 5.4   | 5.5  |
| Fees payable to the auditor and its associates for other services to the Group |       |      |
| - the audit of the Bank's subsidiaries pursuant to legislation                 | 9.2   | 7.9  |
| Total audit and audit-related assurance service fees                           | 14.6  | 13.4 |

Fees payable to the auditor for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

### 6 Tax

|                                                  | Group |       |       |
|--------------------------------------------------|-------|-------|-------|
|                                                  | 2013  | 2012* | 2011* |
|                                                  | £m    | £m    | £m    |
| Current tax                                      |       |       |       |
| (Charge)/credit for the year                     | (229) | (306) | 47    |
| (Under)/over provision in respect of prior years | (49)  | 49    | 173   |
|                                                  | (278) | (257) | 220   |
| Deferred tax                                     |       |       |       |
| Credit/(charge) for the year                     | 288   | (28)  | (902) |
| (Under)/over provision in respect of prior year  | (513) | (51)  | 2     |
| Tax charge for the year                          | (503) | (336) | (680) |

The actual tax charge differs from the expected tax credit computed by applying the standard rate of UK corporation tax of 23.25% (2012 - 24.5%; 2011 - 26.5%) as follows:

|                                                                           | 2013  | 2012* | 2011* |
|---------------------------------------------------------------------------|-------|-------|-------|
|                                                                           | £m    | £m    | £m    |
| Expected tax credit                                                       | 1,572 | 863   | 282   |
| Losses in year where no deferred tax asset recognised                     | (670) | (253) | (334) |
| Foreign profits taxed at other rates                                      | (201) | (380) | (375) |
| UK tax rate change impact (1)                                             | (338) | (152) | (141) |
| Unrecognised timing differences                                           | (8)   | 59    | (20)  |
| Non-deductible goodwill impairment                                        | (49)  | (10)  | (21)  |
| Items not allowed for tax                                                 |       |       |       |
| - losses on disposal and write-downs                                      | (19)  | (36)  | (31)  |
| - UK bank levy                                                            | (47)  | (43)  | (80)  |
| - regulatory and legal action                                             | (144) | (93)  | —     |
| - employee share schemes                                                  | (11)  | (9)   | (113) |
| - other disallowable items                                                | (167) | (209) | (287) |
| Non-taxable items                                                         |       |       |       |
| - gain on sale of RBS Aviation Capital                                    | —     | 26    | —     |
| - gain on sale of WorldPay (Global Merchant Services)                     | 37    | —     | 12    |
| - other non-taxable items                                                 | 92    | 75    | 249   |
| Taxable foreign exchange movements                                        | 12    | 31    | 4     |
| Reduction in carrying value of deferred tax asset in respect of losses in |       |       |       |
| - UK                                                                      | (701) | —     | —     |
| - Ireland                                                                 | —     | (203) | —     |
| Adjustments in respect of prior years (2)                                 | 139   | (2)   | 175   |
| Actual tax charge                                                         | (503) | (336) | (680) |

\*Restated

Notes:

- (1) In recent years the UK Government has steadily reduced the rate of UK corporation tax, with the latest enacted rate standing at 21% with effect from 1 April 2014 and 20% with effect from 1 April 2015. The closing deferred tax assets and liabilities have been calculated in accordance with the rates enacted at the balance sheet date.
- (2) Prior year adjustments include releases of tax provisions in respect of structured transactions and investment disposals and adjustments to reflect submitted tax computations in the UK and overseas.



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## Notes on the accounts

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### 7 Profit attributable to preference shareholders

|                                              | Group |      |      |
|----------------------------------------------|-------|------|------|
|                                              | 2013  | 2012 | 2011 |
|                                              | £m    | £m   | £m   |
| Non-cumulative preference shares of US\$0.01 | 40    | 41   | 40   |
| Non-cumulative preference shares of €0.01    | 18    | 17   | 18   |
| Total                                        | 58    | 58   | 58   |

Note:

(1) Between 1 January 2014 and the date of approval of these accounts, dividends amounting to US\$29 million have been declared in respect of equity preference shares for payment on 31 March 2014.

### 8 Ordinary dividends

The Bank did not pay an ordinary dividend in 2013, 2012 or 2011.

### 9 (Loss)/profit dealt with in the accounts of the Bank

As permitted by section 408(3) of the Companies Act 2006, no income statement for the Bank has been presented as a primary financial statement. Of the loss attributable to ordinary shareholders, £1,257 million loss (2012 - £839 million loss; 2011 - £1,054 million profit) has been dealt with in the accounts of the Bank.

## Notes on the accounts

### 10 Financial instruments - classification

The following tables show the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39 with assets and liabilities outside the scope of IAS 39 shown separately.

|                                                              | Group            |                                                    |                     |                    |                       |                                              |                |                                  |           |
|--------------------------------------------------------------|------------------|----------------------------------------------------|---------------------|--------------------|-----------------------|----------------------------------------------|----------------|----------------------------------|-----------|
|                                                              | Held-for-trading | Designated as at fair value through profit or loss | Hedging derivatives | Available-for-sale | Loans and receivables | Other financial instruments (amortised cost) | Finance leases | Non financial assets/liabilities | Total     |
| 2013                                                         | £m               | £m                                                 | £m                  | £m                 | £m                    | £m                                           | £m             | £m                               | £m        |
| <b>Assets</b>                                                |                  |                                                    |                     |                    |                       |                                              |                |                                  |           |
| Cash and balances at central banks                           | —                | —                                                  | —                   | —                  | 79,993                | —                                            | —              | —                                | 79,993    |
| Loans and advances to banks                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from fellow subsidiaries                       | 3,773            | —                                                  | —                   | —                  | 11,285                | —                                            | —              | —                                | 15,058    |
| - reverse repos                                              | 25,781           | —                                                  | —                   | —                  | 658                   | —                                            | —              | —                                | 26,439    |
| - other (1)                                                  | 9,279            | —                                                  | —                   | —                  | 15,707                | —                                            | —              | —                                | 24,986    |
| Loans and advances to customers                              | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from holding company and fellow subsidiaries   | —                | —                                                  | —                   | —                  | 1,620                 | —                                            | —              | —                                | 1,620     |
| - reverse repos                                              | 49,897           | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 49,897    |
| - other                                                      | 18,849           | 49                                                 | —                   | —                  | 361,935               | —                                            | 6,750          | —                                | 387,583   |
| Debt securities (2)                                          | 56,258           | 14                                                 | —                   | 40,682             | 3,742                 | —                                            | —              | —                                | 100,696   |
| Equity shares                                                | 6,983            | 313                                                | —                   | 982                | —                     | —                                            | —              | —                                | 8,278     |
| Settlement balances                                          | —                | —                                                  | —                   | —                  | 5,634                 | —                                            | —              | —                                | 5,634     |
| Derivatives                                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from holding companies and fellow subsidiaries | 3,413            | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 3,413     |
| - other                                                      | 281,655          | —                                                  | 4,335               | —                  | —                     | —                                            | —              | —                                | 285,990   |
| Intangible assets                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 12,352                           | 12,352    |
| Property, plant and equipment                                | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 7,866                            | 7,866     |
| Deferred tax                                                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 3,435                            | 3,435     |
| Prepayments, accrued income and other assets                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 5,904                            | 5,904     |
| Assets of disposal groups                                    | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 790                              | 790       |
|                                                              | 455,888          | 376                                                | 4,335               | 41,664             | 480,574               | —                                            | 6,750          | 30,347                           | 1,019,934 |
| <b>Liabilities</b>                                           |                  |                                                    |                     |                    |                       |                                              |                |                                  |           |
| Deposits by banks                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to fellow subsidiaries                         | 435              | 10                                                 | —                   | —                  | —                     | 2,018                                        | —              | —                                | 2,463     |
| - repos                                                      | 23,121           | —                                                  | —                   | —                  | —                     | 5,491                                        | —              | —                                | 28,612    |
| - other (3)                                                  | 18,909           | —                                                  | —                   | —                  | —                     | 15,179                                       | —              | —                                | 34,088    |
| Customer accounts                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company                             | 46               | —                                                  | —                   | —                  | —                     | 5,161                                        | —              | —                                | 5,207     |
| - repos                                                      | 52,300           | —                                                  | —                   | —                  | —                     | 4,157                                        | —              | —                                | 56,457    |
| - other (4)                                                  | 9,636            | 5,862                                              | —                   | —                  | —                     | 395,142                                      | —              | —                                | 410,640   |
| Debt securities in issue (5)                                 | 8,570            | 14,998                                             | —                   | —                  | —                     | 36,178                                       | —              | —                                | 59,746    |
| Settlement balances                                          | —                | —                                                  | —                   | —                  | —                     | 5,245                                        | —              | —                                | 5,245     |
| Short positions                                              | 28,004           | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 28,004    |
| Derivatives                                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company and fellow subsidiaries     | 2,586            | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 2,586     |
| - other                                                      | 280,428          | —                                                  | 3,119               | —                  | —                     | —                                            | —              | —                                | 283,547   |
| Accruals, deferred income and other liabilities              | —                | —                                                  | —                   | —                  | —                     | 1,759                                        | 19             | 12,975                           | 14,753    |
| Retirement benefit liabilities                               | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 3,188                            | 3,188     |
| Deferred tax                                                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 189                              | 189       |
| Subordinated liabilities                                     | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company                             | —                | —                                                  | —                   | —                  | —                     | 19,825                                       | —              | —                                | 19,825    |
| - other                                                      | —                | 358                                                | —                   | —                  | —                     | 12,951                                       | —              | —                                | 13,309    |
| Liabilities of disposal groups                               | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 3,210                            | 3,210     |
|                                                              | 424,035          | 21,228                                             | 3,119               | —                  | —                     | 503,106                                      | 19             | 19,562                           | 971,069   |
| Equity                                                       | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 48,865    |
|                                                              | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 1,019,934 |

For the notes to this table refer to page 236.

## Notes on the accounts

### 10 Financial instruments - classification continued

|                                                              | Group            |                                                    |                     |                    |                       |                                              |                |                                  |           |
|--------------------------------------------------------------|------------------|----------------------------------------------------|---------------------|--------------------|-----------------------|----------------------------------------------|----------------|----------------------------------|-----------|
|                                                              | Held-for-trading | Designated as at fair value through profit or loss | Hedging derivatives | Available-for-sale | Loans and receivables | Other financial instruments (amortised cost) | Finance leases | Non financial assets/liabilities | Total     |
| 2012                                                         | £m               | £m                                                 | £m                  | £m                 | £m                    | £m                                           | £m             | £m                               | £m        |
| <b>Assets</b>                                                |                  |                                                    |                     |                    |                       |                                              |                |                                  |           |
| Cash and balances at central banks                           | —                | —                                                  | —                   | —                  | 74,524                | —                                            | —              | —                                | 74,524    |
| Loans and advances to banks                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from fellow subsidiaries                       | 4,401            | 1                                                  | —                   | —                  | 17,473                | —                                            | —              | —                                | 21,875    |
| - reverse repos                                              | 33,388           | —                                                  | —                   | —                  | 1,056                 | —                                            | —              | —                                | 34,444    |
| - other (1)                                                  | 12,022           | —                                                  | —                   | —                  | 13,726                | —                                            | —              | —                                | 25,748    |
| Loans and advances to customers                              | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from holding companies and fellow subsidiaries | 31               | —                                                  | —                   | —                  | 1,835                 | —                                            | —              | —                                | 1,866     |
| - reverse repos                                              | 70,010           | —                                                  | —                   | —                  | 33                    | —                                            | —              | —                                | 70,043    |
| - other                                                      | 24,474           | 189                                                | —                   | —                  | 391,033               | —                                            | 7,232          | —                                | 422,928   |
| Debt securities (2)                                          | 77,030           | 697                                                | —                   | 54,561             | 4,297                 | —                                            | —              | —                                | 136,585   |
| Equity shares                                                | 12,311           | 484                                                | —                   | 1,077              | —                     | —                                            | —              | —                                | 13,872    |
| Settlement balances                                          | —                | —                                                  | —                   | —                  | 5,717                 | —                                            | —              | —                                | 5,717     |
| Derivatives                                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due from holding companies and fellow subsidiaries | 7,200            | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 7,200     |
| - other                                                      | 429,688          | —                                                  | 8,213               | —                  | —                     | —                                            | —              | —                                | 437,901   |
| Intangible assets                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 12,403                           | 12,403    |
| Property, plant and equipment                                | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 9,694                            | 9,694     |
| Deferred tax                                                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 3,066                            | 3,066     |
| Prepayments, accrued income and other assets                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 6,104                            | 6,104     |
| Assets of disposal groups                                    | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 304                              | 304       |
|                                                              | 670,555          | 1,371                                              | 8,213               | 55,638             | 509,694               | —                                            | 7,232          | 31,571                           | 1,284,274 |
| <b>Liabilities</b>                                           |                  |                                                    |                     |                    |                       |                                              |                |                                  |           |
| Deposits by banks                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to fellow subsidiaries                         | 2,188            | —                                                  | —                   | —                  | —                     | 3,875                                        | —              | —                                | 6,063     |
| - repos                                                      | 36,361           | —                                                  | —                   | —                  | —                     | 7,962                                        | —              | —                                | 44,323    |
| - other (3)                                                  | 29,505           | —                                                  | —                   | —                  | —                     | 22,369                                       | —              | —                                | 51,874    |
| Customer accounts                                            | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company and fellow subsidiaries     | 123              | —                                                  | —                   | —                  | —                     | 5,655                                        | —              | —                                | 5,778     |
| - repos                                                      | 82,213           | —                                                  | —                   | —                  | —                     | 5,784                                        | —              | —                                | 87,997    |
| - other (4)                                                  | 11,314           | 6,323                                              | —                   | —                  | —                     | 407,785                                      | —              | —                                | 425,422   |
| Debt securities in issue (5)                                 | 10,820           | 22,183                                             | —                   | —                  | —                     | 50,275                                       | —              | —                                | 83,278    |
| Settlement balances                                          | —                | —                                                  | —                   | —                  | —                     | 5,832                                        | —              | —                                | 5,832     |
| Short positions                                              | 27,541           | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 27,541    |
| Derivatives                                                  | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company and fellow subsidiaries     | 5,580            | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 5,580     |
| - other                                                      | 426,863          | —                                                  | 3,642               | —                  | —                     | —                                            | —              | —                                | 430,505   |
| Accruals, deferred income and other liabilities              | —                | —                                                  | —                   | —                  | —                     | 1,684                                        | 12             | 10,331                           | 12,027    |
| Retirement benefit liabilities                               | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 3,854                            | 3,854     |
| Deferred tax                                                 | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 789                              | 789       |
| Subordinated liabilities                                     | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | —         |
| - amounts due to holding company                             | —                | —                                                  | —                   | —                  | —                     | 18,184                                       | —              | —                                | 18,184    |
| - other                                                      | —                | 538                                                | —                   | —                  | —                     | 15,129                                       | —              | —                                | 15,667    |
| Liabilities of disposal groups                               | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | 135                              | 135       |
|                                                              | 632,508          | 29,044                                             | 3,642               | —                  | —                     | 544,534                                      | 12             | 15,109                           | 1,224,849 |
| Equity                                                       | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 59,425    |
|                                                              | —                | —                                                  | —                   | —                  | —                     | —                                            | —              | —                                | 1,284,274 |

For the notes to this table refer to page 236.

## Notes on the accounts

### 10 Financial instruments - classification continued

|                                                               | Group                  |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
|---------------------------------------------------------------|------------------------|-------------------------------------------------------------------|------------------------------|------------------------------|--------------------------------|----------------------------------------------------------|-------------------------|--------------------------------------------------|-------------|--|
| 2011                                                          | Held-for-trading<br>£m | Designated<br>as at fair value<br>through profit<br>or loss<br>£m | Hedging<br>derivatives<br>£m | Available-<br>for-sale<br>£m | Loans and<br>receivables<br>£m | Other financial<br>instruments<br>(amortised cost)<br>£m | Finance<br>leases<br>£m | Non<br>financial<br>assets/<br>liabilities<br>£m | Total<br>£m |  |
| <b>Assets</b>                                                 |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| Cash and balances at central banks                            | —                      | —                                                                 |                              | —                            | 68,487                         |                                                          |                         |                                                  | 68,487      |  |
| Loans and advances to banks                                   |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due from fellow subsidiaries                        | 13,796                 | 199                                                               |                              | —                            | 13,237                         |                                                          |                         |                                                  | 27,232      |  |
| - reverse repos                                               | 34,659                 | —                                                                 |                              | —                            | 3,101                          |                                                          |                         |                                                  | 37,760      |  |
| - other (1)                                                   | 18,595                 | —                                                                 |                              | —                            | 13,553                         |                                                          |                         |                                                  | 32,148      |  |
| Loans and advances to customers                               |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due from holding company<br>and fellow subsidiaries | 83                     | —                                                                 |                              | —                            | 709                            |                                                          |                         |                                                  | 792         |  |
| - reverse repos                                               | 53,583                 | —                                                                 |                              | —                            | 7,674                          |                                                          |                         |                                                  | 61,257      |  |
| - other                                                       | 24,514                 | 476                                                               |                              | —                            | 393,941                        |                                                          | 8,419                   |                                                  | 427,350     |  |
| Debt securities (2)                                           | 91,761                 | 520                                                               |                              | 71,392                       | 5,468                          |                                                          |                         |                                                  | 169,141     |  |
| Equity shares                                                 | 9,844                  | 575                                                               |                              | 1,343                        | —                              |                                                          |                         |                                                  | 11,762      |  |
| Settlement balances                                           | —                      | —                                                                 |                              | —                            | 6,902                          |                                                          |                         |                                                  | 6,902       |  |
| Derivatives                                                   |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due from holding company<br>and fellow subsidiaries | 10,380                 |                                                                   | —                            |                              |                                |                                                          |                         |                                                  | 10,380      |  |
| - other                                                       | 515,375                |                                                                   | 7,052                        |                              |                                |                                                          |                         |                                                  | 522,427     |  |
| Intangible assets                                             |                        |                                                                   |                              |                              |                                |                                                          |                         | 12,365                                           | 12,365      |  |
| Property, plant and equipment                                 |                        |                                                                   |                              |                              |                                |                                                          |                         | 11,478                                           | 11,478      |  |
| Deferred tax                                                  |                        |                                                                   |                              |                              |                                |                                                          |                         | 3,320                                            | 3,320       |  |
| Prepayments, accrued income and<br>other assets               | —                      | —                                                                 |                              | —                            | 32                             |                                                          |                         | 5,860                                            | 5,892       |  |
| Assets of disposal groups                                     |                        |                                                                   |                              |                              |                                |                                                          |                         | 24,088                                           | 24,088      |  |
|                                                               | 772,590                | 1,770                                                             | 7,052                        | 72,735                       | 513,104                        |                                                          | 8,419                   | 57,111                                           | 1,432,781   |  |
| <b>Liabilities</b>                                            |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| Deposits by banks                                             |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due to fellow subsidiaries                          | 5,879                  | —                                                                 |                              |                              |                                | 6,066                                                    |                         |                                                  | 11,945      |  |
| - repos                                                       | 23,342                 | —                                                                 |                              |                              |                                | 15,558                                                   |                         |                                                  | 38,900      |  |
| - other (3)                                                   | 33,128                 | —                                                                 |                              |                              |                                | 25,124                                                   |                         |                                                  | 58,252      |  |
| Customer accounts                                             |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due to holding company<br>and fellow subsidiaries   | 234                    | —                                                                 |                              |                              |                                | 2,945                                                    |                         |                                                  | 3,179       |  |
| - repos                                                       | 65,526                 | —                                                                 |                              |                              |                                | 22,651                                                   |                         |                                                  | 88,177      |  |
| - other (4)                                                   | 13,435                 | 5,627                                                             |                              |                              |                                | 361,970                                                  |                         |                                                  | 381,032     |  |
| Debt securities in issue (5)                                  | 11,438                 | 26,777                                                            |                              |                              |                                | 102,622                                                  |                         |                                                  | 140,837     |  |
| Settlement balances                                           | —                      | —                                                                 |                              |                              |                                | 6,778                                                    |                         |                                                  | 6,778       |  |
| Short positions                                               | 40,446                 | —                                                                 |                              |                              |                                |                                                          |                         |                                                  | 40,446      |  |
| Derivatives                                                   |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due to holding company<br>and fellow subsidiaries   | 11,377                 |                                                                   | —                            |                              |                                |                                                          |                         |                                                  | 11,377      |  |
| - other                                                       | 512,660                |                                                                   | 3,799                        |                              |                                |                                                          |                         |                                                  | 516,459     |  |
| Accruals, deferred income and other<br>liabilities            | —                      | —                                                                 |                              |                              |                                | 1,683                                                    | 19                      | 13,107                                           | 14,809      |  |
| Retirement benefit liabilities                                |                        |                                                                   |                              |                              |                                |                                                          |                         | 2,188                                            | 2,188       |  |
| Deferred tax                                                  |                        |                                                                   |                              |                              |                                |                                                          |                         | 1,384                                            | 1,384       |  |
| Subordinated liabilities                                      |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |  |
| - amounts due to holding company                              | —                      | —                                                                 |                              |                              |                                | 15,772                                                   |                         |                                                  | 15,772      |  |
| - other                                                       | —                      | 465                                                               |                              |                              |                                | 16,087                                                   |                         |                                                  | 16,552      |  |
| Liabilities of disposal groups                                |                        |                                                                   |                              |                              |                                |                                                          |                         | 22,840                                           | 22,840      |  |
|                                                               | 717,465                | 32,869                                                            | 3,799                        |                              |                                | 577,256                                                  | 19                      | 39,519                                           | 1,370,927   |  |
| Equity                                                        |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  | 61,854      |  |
|                                                               |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  | 1,432,781   |  |

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

## Notes on the accounts

### 10 Financial instruments - classification continued

The above includes amounts due from/to:

|                                 | 2013                     |                              | Group<br>2012            |                              | 2011                     |                              |
|---------------------------------|--------------------------|------------------------------|--------------------------|------------------------------|--------------------------|------------------------------|
|                                 | Holding<br>company<br>£m | Fellow<br>subsidiaries<br>£m | Holding<br>company<br>£m | Fellow<br>subsidiaries<br>£m | Holding<br>company<br>£m | Fellow<br>subsidiaries<br>£m |
| <b>Assets</b>                   |                          |                              |                          |                              |                          |                              |
| Loans and advances to customers | 1,490                    | 130                          | 1,455                    | 411                          | 322                      | 470                          |
| Derivatives                     | 53                       | 3,360                        | 7                        | 7,193                        | 79                       | 10,301                       |
| <b>Liabilities</b>              |                          |                              |                          |                              |                          |                              |
| Customer accounts               | 5,207                    | —                            | 5,777                    | 1                            | 2,596                    | 583                          |
| Derivatives                     | 153                      | 2,433                        | 511                      | 5,069                        | 1,502                    | 9,875                        |

**Notes:**

- (1) Includes items in the course of collection from other banks of £1,454 million (2012 - £1,531 million; 2011 - £1,470 million).
- (2) Debt securities balances with Group companies are shown on pages 126 to 128.
- (3) Includes items in the course of transmission to other banks of £826 million (2012 - £521 million; 2011 - £506 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £412 million (2012 - £305 million; 2011 - £166 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial, measured as the change in fair value from movements in the period in the credit risk premium payable
- (5) Comprises bonds and medium term notes of £57,035 million (2012 - £79,565 million; 2011 - £112,220 million) and certificates of deposit and other commercial paper of £2,711 million (2012 - £3,713 million; 2011 - £28,617 million).

Amounts included in the consolidated income statement:

|                                                                                                   | Group      |            |            |
|---------------------------------------------------------------------------------------------------|------------|------------|------------|
|                                                                                                   | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| (Losses)/gains on financial assets/liabilities designated as at fair value through profit or loss | (88)       | (1,973)    | 795        |
| (Losses)/gains on disposal or settlement of loans and receivables                                 | (206)      | (76)       | 13         |

## Notes on the accounts

### 10 Financial instruments - classification continued

The following tables show the Bank's financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39 with assets and liabilities outside the scope of IAS 39 shown separately.

|                                                        | Bank                   |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
|--------------------------------------------------------|------------------------|-------------------------------------------------------------------|------------------------------|------------------------------|--------------------------------|----------------------------------------------------------|-------------------------|--------------------------------------------------|-------------|
|                                                        | Held-for-trading<br>£m | Designated<br>as at fair value<br>through profit<br>or loss<br>£m | Hedging<br>derivatives<br>£m | Available-<br>for-sale<br>£m | Loans and<br>receivables<br>£m | Other financial<br>instruments<br>(amortised cost)<br>£m | Finance<br>leases<br>£m | Non<br>financial<br>assets/<br>liabilities<br>£m | Total<br>£m |
| 2013                                                   |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| <b>Assets</b>                                          |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| Cash and balances at central banks                     | —                      | —                                                                 |                              | —                            | 75,792                         |                                                          |                         |                                                  | 75,792      |
| Loans and advances to banks                            |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due from subsidiaries                        | 8,142                  | —                                                                 |                              | —                            | 32,968                         |                                                          |                         |                                                  | 41,110      |
| - reverse repos                                        | 18,684                 | —                                                                 |                              | —                            | 427                            |                                                          |                         |                                                  | 19,111      |
| - other (1)                                            | 9,278                  | —                                                                 |                              | —                            | 8,269                          |                                                          |                         |                                                  | 17,547      |
| Loans and advances to customers                        |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due from holding company<br>and subsidiaries | 20,529                 | —                                                                 |                              | 8                            | 29,408                         |                                                          |                         |                                                  | 49,945      |
| - reverse repos                                        | 24,651                 | —                                                                 |                              | —                            | —                              |                                                          |                         |                                                  | 24,651      |
| - other                                                | 18,525                 | 49                                                                |                              | —                            | 132,169                        |                                                          | 35                      | —                                                | 150,778     |
| Debt securities (2)                                    | 34,412                 | 456                                                               |                              | 28,251                       | 29,208                         |                                                          |                         | —                                                | 92,327      |
| Equity shares                                          | 6,949                  | 107                                                               |                              | 245                          | —                              |                                                          |                         | —                                                | 7,301       |
| Investment in Group undertakings                       | —                      | —                                                                 |                              | —                            | —                              |                                                          |                         | 42,328                                           | 42,328      |
| Settlement balances                                    | —                      | —                                                                 |                              | —                            | 3,492                          |                                                          |                         | —                                                | 3,492       |
| Derivatives                                            |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due from holding company<br>and subsidiaries | 8,967                  |                                                                   | —                            |                              |                                |                                                          |                         |                                                  | 8,967       |
| - other                                                | 280,300                |                                                                   | 3,613                        |                              |                                |                                                          |                         |                                                  | 283,913     |
| Intangible assets                                      |                        |                                                                   |                              |                              |                                |                                                          |                         | 1,127                                            | 1,127       |
| Property, plant and equipment                          |                        |                                                                   |                              |                              |                                |                                                          |                         | 2,284                                            | 2,284       |
| Deferred tax                                           |                        |                                                                   |                              |                              |                                |                                                          |                         | 2,298                                            | 2,298       |
| Prepayments, accrued income and other assets           | —                      | —                                                                 | —                            | —                            | —                              |                                                          |                         | 3,246                                            | 3,246       |
|                                                        | 430,437                | 612                                                               | 3,613                        | 28,504                       | 311,733                        |                                                          | 35                      | 51,283                                           | 826,217     |
| <b>Liabilities</b>                                     |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| Deposits by banks                                      |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due to subsidiaries                          | 4,198                  | 20                                                                |                              |                              |                                | 128,997                                                  |                         |                                                  | 133,215     |
| - repos                                                | 16,199                 | —                                                                 |                              |                              |                                | 3,588                                                    |                         |                                                  | 19,787      |
| - other (3)                                            | 18,601                 | —                                                                 |                              |                              |                                | 8,690                                                    |                         |                                                  | 27,291      |
| Customer accounts                                      |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due to holding company<br>and subsidiaries   | 12,550                 | 495                                                               |                              |                              |                                | 34,354                                                   |                         |                                                  | 47,399      |
| - repos                                                | 23,531                 | —                                                                 |                              |                              |                                | 3,490                                                    |                         |                                                  | 27,021      |
| - other (4)                                            | 9,594                  | 829                                                               |                              |                              |                                | 108,710                                                  |                         |                                                  | 119,133     |
| Debt securities in issue (5)                           | 8,570                  | 14,063                                                            |                              |                              |                                | 28,905                                                   |                         |                                                  | 51,538      |
| Settlement balances                                    | —                      | —                                                                 |                              |                              |                                | 2,274                                                    |                         |                                                  | 2,274       |
| Short positions                                        | 17,898                 | —                                                                 |                              |                              |                                | —                                                        |                         |                                                  | 17,898      |
| Derivatives                                            |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due to holding company<br>and subsidiaries   | 5,675                  |                                                                   | —                            |                              |                                |                                                          |                         |                                                  | 5,675       |
| - other                                                | 281,079                |                                                                   | 1,753                        |                              |                                | —                                                        |                         |                                                  | 282,832     |
| Accruals, deferred income and other liabilities        | —                      | —                                                                 |                              |                              |                                | 1,124                                                    |                         | 6,077                                            | 7,201       |
| Retirement benefit liabilities                         |                        |                                                                   |                              |                              |                                | —                                                        |                         | 65                                               | 65          |
| Deferred tax                                           |                        |                                                                   |                              |                              |                                | —                                                        |                         | —                                                | —           |
| Subordinated liabilities                               |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  |             |
| - amounts due to holding company                       | —                      | —                                                                 | —                            |                              |                                | 19,399                                                   |                         |                                                  | 19,399      |
| - other                                                | —                      | 358                                                               | —                            |                              |                                | 10,809                                                   |                         |                                                  | 11,167      |
|                                                        | 397,895                | 15,765                                                            | 1,753                        |                              |                                | 350,340                                                  | —                       | 6,142                                            | 771,895     |
| <b>Equity</b>                                          |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  | 54,322      |
|                                                        |                        |                                                                   |                              |                              |                                |                                                          |                         |                                                  | 826,217     |

For the notes to this table refer to page 240.

## Notes on the accounts

### 10 Financial instruments - classification continued

|                                                        | Bank                   |                                                                   |                              |                              |                                |                                                          |                                                  |             |
|--------------------------------------------------------|------------------------|-------------------------------------------------------------------|------------------------------|------------------------------|--------------------------------|----------------------------------------------------------|--------------------------------------------------|-------------|
|                                                        | Held-for-trading<br>£m | Designated<br>as at fair value<br>through profit<br>or loss<br>£m | Hedging<br>derivatives<br>£m | Available-<br>for-sale<br>£m | Loans and<br>receivables<br>£m | Other financial<br>instruments<br>(amortised cost)<br>£m | Non<br>financial<br>assets/<br>liabilities<br>£m | Total<br>£m |
| 2012                                                   |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| <b>Assets</b>                                          |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Cash and balances at central banks                     | —                      | —                                                                 |                              | —                            | 70,374                         |                                                          |                                                  | 70,374      |
| Loans and advances to banks                            |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from subsidiaries                        | 7,111                  | 1                                                                 |                              | —                            | 58,559                         |                                                          |                                                  | 65,671      |
| - reverse repos                                        | 25,594                 | —                                                                 |                              | —                            | —                              |                                                          |                                                  | 25,594      |
| - other (1)                                            | 12,015                 | —                                                                 |                              | —                            | 6,291                          |                                                          |                                                  | 18,306      |
| Loans and advances to customers                        |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from holding company<br>and subsidiaries | 19,254                 | —                                                                 |                              | 12                           | 36,202                         |                                                          |                                                  | 55,468      |
| - reverse repos                                        | 42,972                 | —                                                                 |                              | —                            | 23                             |                                                          |                                                  | 42,995      |
| - other                                                | 23,555                 | 134                                                               |                              | —                            | 149,397                        |                                                          |                                                  | 173,086     |
| Debt securities (2)                                    | 42,899                 | 1,242                                                             |                              | 43,059                       | 35,247                         |                                                          |                                                  | 122,447     |
| Equity shares                                          | 12,278                 | 274                                                               |                              | 214                          | —                              |                                                          |                                                  | 12,766      |
| Investment in Group undertakings                       |                        |                                                                   |                              |                              |                                |                                                          | 40,262                                           | 40,262      |
| Settlement balances                                    | —                      | —                                                                 |                              | —                            | 3,090                          |                                                          |                                                  | 3,090       |
| Derivatives                                            |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from holding company<br>and subsidiaries | 14,953                 |                                                                   | —                            |                              |                                |                                                          |                                                  | 14,953      |
| - other                                                | 428,261                |                                                                   | 6,624                        |                              |                                |                                                          |                                                  | 434,885     |
| Intangible assets                                      |                        |                                                                   |                              |                              |                                |                                                          | 1,033                                            | 1,033       |
| Property, plant and equipment                          |                        |                                                                   |                              |                              |                                |                                                          | 2,430                                            | 2,430       |
| Deferred tax                                           |                        |                                                                   |                              |                              |                                |                                                          | 2,878                                            | 2,878       |
| Prepayments, accrued income and other assets           | —                      | —                                                                 |                              | —                            | —                              |                                                          | 4,433                                            | 4,433       |
|                                                        | 628,892                | 1,651                                                             | 6,624                        | 43,285                       | 359,183                        |                                                          | 51,036                                           | 1,090,671   |
| <b>Liabilities</b>                                     |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Deposits by banks                                      |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to subsidiaries                          | 6,897                  | 84                                                                |                              |                              |                                | 123,145                                                  |                                                  | 130,126     |
| - repos                                                | 27,499                 | —                                                                 |                              |                              |                                | 6,078                                                    |                                                  | 33,577      |
| - other (3)                                            | 29,087                 | —                                                                 |                              |                              |                                | 16,793                                                   |                                                  | 45,880      |
| Customer accounts                                      |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company and subsidiaries      | 18,900                 | 567                                                               |                              |                              |                                | 65,525                                                   |                                                  | 84,992      |
| - repos                                                | 37,460                 | —                                                                 |                              |                              |                                | 4,727                                                    |                                                  | 42,187      |
| - other (4)                                            | 11,299                 | 1,024                                                             |                              |                              |                                | 116,832                                                  |                                                  | 129,155     |
| Debt securities in issue (5)                           | 10,820                 | 21,220                                                            |                              |                              |                                | 39,454                                                   |                                                  | 71,494      |
| Settlement balances                                    | —                      | —                                                                 |                              |                              |                                | 2,878                                                    |                                                  | 2,878       |
| Short positions                                        | 14,074                 | —                                                                 |                              |                              |                                | —                                                        |                                                  | 14,074      |
| Derivatives                                            |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company and subsidiaries      | 9,321                  |                                                                   | —                            |                              |                                |                                                          |                                                  | 9,321       |
| - other                                                | 428,082                | —                                                                 | 1,749                        |                              |                                |                                                          |                                                  | 429,831     |
| Accruals, deferred income and other liabilities        | —                      | —                                                                 |                              |                              |                                | 1,106                                                    | 6,249                                            | 7,355       |
| Retirement benefit liabilities                         |                        |                                                                   |                              |                              |                                |                                                          | 56                                               | 56          |
| Deferred tax                                           |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Subordinated liabilities                               |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company                       | —                      | —                                                                 |                              |                              |                                | 18,184                                                   |                                                  | 18,184      |
| - other                                                | —                      | 538                                                               |                              |                              |                                | 12,913                                                   |                                                  | 13,451      |
|                                                        | 593,439                | 23,433                                                            | 1,749                        |                              |                                | 407,635                                                  | 6,305                                            | 1,032,561   |
| <b>Equity</b>                                          |                        |                                                                   |                              |                              |                                |                                                          |                                                  | 58,110      |
|                                                        |                        |                                                                   |                              |                              |                                |                                                          |                                                  | 1,090,671   |

For the notes to this table refer to page 240.

## Notes on the accounts

### 10 Financial instruments - classification continued

|                                                     | Bank                   |                                                                   |                              |                              |                                |                                                          |                                                  |             |
|-----------------------------------------------------|------------------------|-------------------------------------------------------------------|------------------------------|------------------------------|--------------------------------|----------------------------------------------------------|--------------------------------------------------|-------------|
|                                                     | Held-for-trading<br>£m | Designated<br>as at fair value<br>through profit<br>or loss<br>£m | Hedging<br>derivatives<br>£m | Available-<br>for-sale<br>£m | Loans and<br>receivables<br>£m | Other financial<br>instruments<br>(amortised cost)<br>£m | Non<br>financial<br>assets/<br>liabilities<br>£m | Total<br>£m |
| 2011                                                |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| <b>Assets</b>                                       |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Cash and balances at central banks                  | —                      | —                                                                 |                              | —                            | 64,261                         |                                                          |                                                  | 64,261      |
| Loans and advances to banks                         |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from subsidiaries                     | 14,886                 | 199                                                               |                              | —                            | 43,887                         |                                                          |                                                  | 58,972      |
| - reverse repos                                     | 25,396                 | —                                                                 |                              | —                            | 14                             |                                                          |                                                  | 25,410      |
| - other (1)                                         | 18,589                 | —                                                                 |                              | —                            | 6,069                          |                                                          |                                                  | 24,658      |
| Loans and advances to customers                     |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from holding company and subsidiaries | 13,181                 | —                                                                 |                              | —                            | 132,576                        |                                                          |                                                  | 145,757     |
| - reverse repos                                     | 40,797                 | —                                                                 |                              | —                            | 1,251                          |                                                          |                                                  | 42,048      |
| - other                                             | 23,785                 | 386                                                               |                              | —                            | 139,147                        |                                                          |                                                  | 163,318     |
| Debt securities (2)                                 | 51,670                 | 1,266                                                             |                              | 57,288                       | 71,236                         |                                                          |                                                  | 181,460     |
| Equity shares                                       | 9,793                  | 329                                                               |                              | 364                          | —                              |                                                          |                                                  | 10,486      |
| Investment in Group undertakings                    |                        |                                                                   |                              |                              |                                |                                                          | 32,164                                           | 32,164      |
| Settlement balances                                 | —                      | —                                                                 |                              | —                            | 4,059                          |                                                          |                                                  | 4,059       |
| Derivatives                                         |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due from holding company and subsidiaries | 18,457                 | —                                                                 | —                            |                              |                                |                                                          |                                                  | 18,457      |
| - other                                             | 513,041                | —                                                                 | 5,799                        |                              |                                |                                                          |                                                  | 518,840     |
| Intangible assets                                   |                        |                                                                   |                              |                              |                                |                                                          | 876                                              | 876         |
| Property, plant and equipment                       |                        |                                                                   |                              |                              |                                |                                                          | 2,244                                            | 2,244       |
| Deferred tax                                        |                        |                                                                   |                              |                              |                                |                                                          | 2,584                                            | 2,584       |
| Prepayments, accrued income and other assets        | —                      | —                                                                 |                              | —                            | —                              |                                                          | 5,338                                            | 5,338       |
| Assets of disposal groups                           |                        |                                                                   |                              |                              |                                |                                                          | 18,715                                           | 18,715      |
|                                                     | 729,595                | 2,180                                                             | 5,799                        | 57,652                       | 462,500                        |                                                          | 61,921                                           | 1,319,647   |
| <b>Liabilities</b>                                  |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Deposits by banks                                   |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to subsidiaries                       | 10,257                 | —                                                                 |                              |                              |                                | 147,742                                                  |                                                  | 157,999     |
| - repos                                             | 21,406                 | —                                                                 |                              |                              |                                | 7,311                                                    |                                                  | 28,717      |
| - other (3)                                         | 32,389                 | —                                                                 |                              |                              |                                | 15,192                                                   |                                                  | 47,581      |
| Customer accounts                                   |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company and subsidiaries   | 23,061                 | 756                                                               |                              |                              |                                | 139,798                                                  |                                                  | 163,615     |
| - repos                                             | 32,458                 | —                                                                 |                              |                              |                                | 4,670                                                    |                                                  | 37,128      |
| - other (4)                                         | 13,310                 | 832                                                               |                              |                              |                                | 82,017                                                   |                                                  | 96,159      |
| Debt securities in issue (5)                        | 11,438                 | 26,773                                                            |                              |                              |                                | 76,313                                                   |                                                  | 114,524     |
| Settlement balances                                 | —                      | —                                                                 |                              |                              |                                | 3,517                                                    |                                                  | 3,517       |
| Short positions                                     | 24,858                 | —                                                                 |                              |                              |                                |                                                          |                                                  | 24,858      |
| Derivatives                                         |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company and subsidiaries   | 15,505                 |                                                                   | —                            |                              |                                |                                                          |                                                  | 15,505      |
| - other                                             | 513,599                |                                                                   | 1,751                        |                              |                                |                                                          |                                                  | 515,350     |
| Accruals, deferred income and other liabilities     | —                      | —                                                                 |                              |                              |                                | 1,130                                                    | 7,710                                            | 8,840       |
| Retirement benefit liabilities                      |                        |                                                                   |                              |                              |                                |                                                          | 25                                               | 25          |
| Deferred tax                                        |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| Subordinated liabilities                            |                        |                                                                   |                              |                              |                                |                                                          |                                                  |             |
| - amounts due to holding company                    | —                      | —                                                                 |                              |                              |                                | 15,772                                                   |                                                  | 15,772      |
| - other                                             | —                      | 465                                                               |                              |                              |                                | 13,777                                                   |                                                  | 14,242      |
| Liabilities of disposal groups                      |                        |                                                                   |                              |                              |                                |                                                          | 20,478                                           | 20,478      |
|                                                     | 698,281                | 28,826                                                            | 1,751                        |                              |                                | 507,239                                                  | 28,213                                           | 1,264,310   |
| <b>Equity</b>                                       |                        |                                                                   |                              |                              |                                |                                                          |                                                  | 55,337      |
|                                                     |                        |                                                                   |                              |                              |                                |                                                          |                                                  | 1,319,647   |

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



## Notes on the accounts

### 10 Financial instruments - classification continued

The above includes amounts due from/to:

|                                 | 2013                  |                           |                    | Bank<br>2012          |                           |                    | 2011                  |                           |                    |
|---------------------------------|-----------------------|---------------------------|--------------------|-----------------------|---------------------------|--------------------|-----------------------|---------------------------|--------------------|
|                                 | Holding company<br>£m | Fellow subsidiaries<br>£m | Subsidiaries<br>£m | Holding company<br>£m | Fellow subsidiaries<br>£m | Subsidiaries<br>£m | Holding company<br>£m | Fellow subsidiaries<br>£m | Subsidiaries<br>£m |
| <b>Assets</b>                   |                       |                           |                    |                       |                           |                    |                       |                           |                    |
| Loans and advances to banks     | —                     | 15,671                    | 25,439             | —                     | 21,875                    | 43,796             | —                     | 118                       | 58,854             |
| Loans and advances to customers | 1,490                 | 130                       | 48,325             | 1,455                 | 290                       | 53,723             | 322                   | 27,131                    | 118,304            |
| Derivatives                     | 53                    | 3,359                     | 5,555              | 7                     | 7,186                     | 7,760              | 79                    | 10,297                    | 8,081              |
| <b>Liabilities</b>              |                       |                           |                    |                       |                           |                    |                       |                           |                    |
| Deposits by banks               | —                     | 2,734                     | 130,481            | —                     | 5,015                     | 125,111            | —                     | 672                       | 157,327            |
| Customer accounts               | 5,207                 | —                         | 42,192             | 5,777                 | 1                         | 79,214             | 2,596                 | 10,339                    | 150,680            |
| Derivatives                     | 153                   | 2,433                     | 3,089              | 511                   | 5,069                     | 3,741              | 1,502                 | 9,870                     | 4,133              |

Notes:

- (1) Includes items in the course of collection from other banks of £349 million (2012 - £303 million; 2011 - £316 million).
- (2) Debt securities balances with Group companies are shown on page 129.
- (3) Includes items in the course of transmission to other banks of £348 million (2012 - £63 million; 2011 - £138 million).
- (4) The carrying amount of other customer accounts designated as at fair value through profit or loss is £65 million higher (2012 - £43 million; 2011 - £46 million) higher than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable.
- (5) Comprises bonds and medium term notes of £49,697 million (2012 - £68,530 million; 2011 - £97,838 million) and certificates of deposit and other commercial paper of £1,841 million (2012 - £2,964 million; 2011 - £16,686 million).

The tables below present information on financial assets and liabilities that are offset in the balance sheet under IFRS or subject to enforceable master netting agreements only, together with financial collateral received or given.

| 2013                          | Group          |                   |                     |                                                                |                       |                                  |                                                                              |
|-------------------------------|----------------|-------------------|---------------------|----------------------------------------------------------------|-----------------------|----------------------------------|------------------------------------------------------------------------------|
|                               | Gross<br>£m    | IFRS offset<br>£m | Balance sheet<br>£m | Effect of master netting agreements/similar Arrangements<br>£m | Cash collateral<br>£m | Other financial collateral<br>£m | Net amount after effect of netting arrangements and related collateral<br>£m |
| <b>Assets</b>                 |                |                   |                     |                                                                |                       |                                  |                                                                              |
| Derivatives                   | 548,743        | (265,709)         | 283,034             | (244,395)                                                      | (23,579)              | (5,990)                          | 9,070                                                                        |
| Reverse repurchase agreements | 115,715        | (40,658)          | 75,057              | (11,379)                                                       | —                     | (63,589)                         | 89                                                                           |
| Loans to customers            | 2,152          | (2,152)           | —                   | —                                                              | —                     | —                                | —                                                                            |
| Settlement balances           | 2,950          | (2,672)           | 278                 | (262)                                                          | —                     | —                                | 16                                                                           |
|                               | <b>669,560</b> | <b>(311,191)</b>  | <b>358,369</b>      | <b>(256,036)</b>                                               | <b>(23,579)</b>       | <b>(69,579)</b>                  | <b>9,175</b>                                                                 |
| <b>Liabilities</b>            |                |                   |                     |                                                                |                       |                                  |                                                                              |
| Derivatives                   | 543,393        | (262,655)         | 280,738             | (244,395)                                                      | (20,440)              | (5,202)                          | 10,701                                                                       |
| Repurchase agreements         | 120,639        | (40,658)          | 79,981              | (11,379)                                                       | —                     | (68,602)                         | —                                                                            |
| Customer accounts             | 5,206          | (5,206)           | —                   | —                                                              | —                     | —                                | —                                                                            |
| Settlement balances           | 4,006          | (2,672)           | 1,334               | (262)                                                          | —                     | —                                | 1,072                                                                        |
|                               | <b>673,244</b> | <b>(311,191)</b>  | <b>362,053</b>      | <b>(256,036)</b>                                               | <b>(20,440)</b>       | <b>(73,804)</b>                  | <b>11,773</b>                                                                |

## Notes on the accounts

### 10 Financial instruments - classification continued

|                               |                  |                  |                | Group              |                 |                  |                         |
|-------------------------------|------------------|------------------|----------------|--------------------|-----------------|------------------|-------------------------|
|                               | Gross            | IFRS offset      | Balance sheet  | Effect of          | Cash            | Other financial  | Net amount after effect |
|                               | £m               | £m               | £m             | master netting     | collateral      | collateral       | of netting arrangements |
|                               |                  |                  |                | agreements/similar |                 |                  | and related collateral  |
|                               |                  |                  |                | arrangements       |                 |                  |                         |
|                               |                  |                  |                | £m                 | £m              | £m               | £m                      |
| <b>2012</b>                   |                  |                  |                |                    |                 |                  |                         |
| <b>Assets</b>                 |                  |                  |                |                    |                 |                  |                         |
| Derivatives                   | 801,520          | (373,448)        | 428,072        | (373,767)          | (33,440)        | (5,616)          | 15,249                  |
| Reverse repurchase agreements | 139,120          | (38,377)         | 100,743        | (17,439)           | —               | (83,304)         | —                       |
| Settlement balances           | 3,680            | (2,456)          | 1,224          | (345)              | —               | —                | 879                     |
|                               | <b>944,320</b>   | <b>(414,281)</b> | <b>530,039</b> | <b>(391,551)</b>   | <b>(33,440)</b> | <b>(88,920)</b>  | <b>16,128</b>           |
| <b>Liabilities</b>            |                  |                  |                |                    |                 |                  |                         |
| Derivatives                   | 796,908          | (373,448)        | 423,460        | (373,767)          | (24,546)        | (8,264)          | 16,883                  |
| Repurchase agreements         | 158,094          | (38,377)         | 119,717        | (17,439)           | —               | (102,278)        | —                       |
| Settlement balances           | 4,270            | (2,456)          | 1,814          | (345)              | —               | —                | 1,469                   |
|                               | <b>959,272</b>   | <b>(414,281)</b> | <b>544,991</b> | <b>(391,551)</b>   | <b>(24,546)</b> | <b>(110,542)</b> | <b>18,352</b>           |
| <b>2011</b>                   |                  |                  |                |                    |                 |                  |                         |
| <b>Assets</b>                 |                  |                  |                |                    |                 |                  |                         |
| Derivatives                   | 1,050,011        | (544,207)        | 505,804        | (440,947)          | (36,358)        | (5,312)          | 23,187                  |
| Reverse repurchase agreements | 128,426          | (37,584)         | 90,842         | (15,246)           | —               | (75,596)         | —                       |
| Settlement balances           | 2,087            | (1,359)          | 728            | (728)              | —               | —                | —                       |
|                               | <b>1,180,524</b> | <b>(583,150)</b> | <b>597,374</b> | <b>(456,921)</b>   | <b>(36,358)</b> | <b>(80,908)</b>  | <b>23,187</b>           |
| <b>Liabilities</b>            |                  |                  |                |                    |                 |                  |                         |
| Derivatives                   | 1,048,397        | (544,207)        | 504,190        | (440,947)          | (30,345)        | (8,585)          | 24,313                  |
| Reverse repurchase agreements | 150,368          | (37,584)         | 112,784        | (15,246)           | —               | (97,538)         | —                       |
| Settlement balances           | 2,087            | (1,359)          | 728            | (728)              | —               | —                | —                       |
|                               | <b>1,200,852</b> | <b>(583,150)</b> | <b>617,702</b> | <b>(456,921)</b>   | <b>(30,345)</b> | <b>(106,123)</b> | <b>24,313</b>           |

## Notes on the accounts

### 10 Financial instruments - classification continued

|                               |                  |                   |                     | Bank<br>Effect of<br>master netting<br>agreements/similar<br>Arrangements | Cash<br>collateral | Other financial<br>collateral | Net amount after effect<br>of netting arrangements<br>and related collateral |
|-------------------------------|------------------|-------------------|---------------------|---------------------------------------------------------------------------|--------------------|-------------------------------|------------------------------------------------------------------------------|
|                               | Gross<br>£m      | IFRS offset<br>£m | Balance sheet<br>£m | £m                                                                        | £m                 | £m                            | £m                                                                           |
| <b>2013</b>                   |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| <b>Assets</b>                 |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 553,861          | (265,486)         | 288,375             | (246,507)                                                                 | (23,579)           | (5,990)                       | 12,299                                                                       |
| Reverse repurchase agreements | 59,872           | (17,151)          | 42,721              | (7,319)                                                                   | —                  | (35,402)                      | —                                                                            |
| Loans to customers            | 2,152            | (2,152)           | —                   | —                                                                         | —                  | —                             | —                                                                            |
| Settlement balances           | 62               | (62)              | —                   | —                                                                         | —                  | —                             | —                                                                            |
|                               | <b>615,947</b>   | <b>(284,851)</b>  | <b>331,096</b>      | <b>(253,826)</b>                                                          | <b>(23,579)</b>    | <b>(41,392)</b>               | <b>12,299</b>                                                                |
| <b>Liabilities</b>            |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 546,002          | (262,432)         | 283,570             | (246,507)                                                                 | (20,440)           | (5,202)                       | 11,421                                                                       |
| Repurchase agreements         | 62,120           | (17,151)          | 44,969              | (7,319)                                                                   | —                  | (37,650)                      | —                                                                            |
| Customer accounts             | 5,206            | (5,206)           | —                   | —                                                                         | —                  | —                             | —                                                                            |
| Settlement balances           | 62               | (62)              | —                   | —                                                                         | —                  | —                             | —                                                                            |
|                               | <b>613,390</b>   | <b>(284,851)</b>  | <b>328,539</b>      | <b>(253,826)</b>                                                          | <b>(20,440)</b>    | <b>(42,852)</b>               | <b>11,421</b>                                                                |
| <b>2012</b>                   |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| <b>Assets</b>                 |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 801,311          | (373,264)         | 428,047             | (373,742)                                                                 | (33,440)           | (5,616)                       | 15,249                                                                       |
| Reverse repurchase agreements | 76,328           | (10,097)          | 66,231              | (14,762)                                                                  | —                  | (51,469)                      | —                                                                            |
| Settlement balances           | 515              | (472)             | 43                  | (43)                                                                      | —                  | —                             | —                                                                            |
|                               | <b>878,154</b>   | <b>(383,833)</b>  | <b>494,321</b>      | <b>(388,547)</b>                                                          | <b>(33,440)</b>    | <b>(57,085)</b>               | <b>15,249</b>                                                                |
| <b>Liabilities</b>            |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 796,699          | (373,264)         | 423,435             | (373,742)                                                                 | (24,593)           | (8,264)                       | 16,836                                                                       |
| Repurchase agreements         | 75,738           | (10,097)          | 65,641              | (14,762)                                                                  | —                  | (50,879)                      | —                                                                            |
| Settlement balances           | 515              | (472)             | 43                  | (43)                                                                      | —                  | —                             | —                                                                            |
|                               | <b>872,952</b>   | <b>(383,833)</b>  | <b>489,119</b>      | <b>(388,547)</b>                                                          | <b>(24,593)</b>    | <b>(59,143)</b>               | <b>16,836</b>                                                                |
| <b>2011</b>                   |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| <b>Assets</b>                 |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 1,049,462        | (543,736)         | 505,726             | (440,869)                                                                 | (36,358)           | (5,312)                       | 23,187                                                                       |
| Reverse repurchase agreements | 76,525           | (16,986)          | 59,539              | (9,867)                                                                   | —                  | (49,672)                      | —                                                                            |
| Settlement balances           | 637              | (441)             | 196                 | (196)                                                                     | —                  | —                             | —                                                                            |
|                               | <b>1,126,624</b> | <b>(561,163)</b>  | <b>565,461</b>      | <b>(450,932)</b>                                                          | <b>(36,358)</b>    | <b>(54,984)</b>               | <b>23,187</b>                                                                |
| <b>Liabilities</b>            |                  |                   |                     |                                                                           |                    |                               |                                                                              |
| Derivatives                   | 1,047,839        | (543,736)         | 504,103             | (440,869)                                                                 | (30,345)           | (8,585)                       | 24,304                                                                       |
| Reverse repurchase agreements | 70,550           | (16,986)          | 53,564              | (9,867)                                                                   | —                  | (43,697)                      | —                                                                            |
| Settlement balances           | 637              | (441)             | 196                 | (196)                                                                     | —                  | —                             | —                                                                            |
|                               | <b>1,119,026</b> | <b>(561,163)</b>  | <b>557,863</b>      | <b>(450,932)</b>                                                          | <b>(30,345)</b>    | <b>(52,282)</b>               | <b>24,304</b>                                                                |

## Notes on the accounts

### 10 Financial instruments - classification continued

#### Reclassification of financial instruments

In 2008 and 2009, the Group and Bank reclassified financial assets from the held-for-trading (HFT) and available-for-sale (AFS) categories into the loans and receivables (LAR) category (as permitted by paragraph 50D of IAS 39 as amended) and from the HFT category into the AFS category (as permitted by paragraph 50B of IAS 39 as amended).

The tables below show the carrying value, fair value and the effect on profit or loss of reclassifications undertaken by the Group in 2008 and 2009. There have been no further reclassifications.

|                                             | Group          |            |                                       |                               |                                                                          |                                                                         |
|---------------------------------------------|----------------|------------|---------------------------------------|-------------------------------|--------------------------------------------------------------------------|-------------------------------------------------------------------------|
|                                             |                |            | Amount recognised in income statement |                               | Amount that would have been recognised had reclassification not occurred | Reduction/ (increase) in profit or loss as a result of reclassification |
|                                             | Carrying value | Fair value | Income                                | Impairment (losses) releases/ |                                                                          |                                                                         |
|                                             | £m             | £m         | £m                                    | £m                            | £m                                                                       | £m                                                                      |
| 2013                                        |                |            |                                       |                               |                                                                          |                                                                         |
| Reclassified from HFT to LAR                |                |            |                                       |                               |                                                                          |                                                                         |
| Loans                                       | 1,417          | 1,160      | (28)                                  | (13)                          | 42                                                                       | 83                                                                      |
| Debt securities                             | 1,284          | 892        | (23)                                  | 3                             | (88)                                                                     | (68)                                                                    |
|                                             | 2,701          | 2,052      | (51)                                  | (10)                          | (46)                                                                     | 15                                                                      |
| Reclassified from HFT to AFS <sup>(1)</sup> |                |            |                                       |                               |                                                                          |                                                                         |
| Debt securities                             | 62             | 62         | 34                                    | 1                             | 45                                                                       | 10                                                                      |
| Reclassified from AFS to LAR <sup>(2)</sup> |                |            |                                       |                               |                                                                          |                                                                         |
| Debt securities                             | —              | —          | 4                                     | 7                             | —                                                                        | (11)                                                                    |
|                                             | 2,763          | 2,114      | (13)                                  | (2)                           | (1)                                                                      | 14                                                                      |
| 2012                                        |                |            |                                       |                               |                                                                          |                                                                         |
| Reclassified from HFT to LAR                |                |            |                                       |                               |                                                                          |                                                                         |
| Loans                                       | 2,892          | 2,546      | 42                                    | 15                            | 517                                                                      | 460                                                                     |
| Debt securities                             | 1,548          | 1,232      | (107)                                 | (2)                           | 184                                                                      | 293                                                                     |
|                                             | 4,440          | 3,778      | (65)                                  | 13                            | 701                                                                      | 753                                                                     |
| Reclassified from HFT to AFS <sup>(1)</sup> |                |            |                                       |                               |                                                                          |                                                                         |
| Debt securities                             | 891            | 891        | 38                                    | 8                             | 13                                                                       | (33)                                                                    |
| Reclassified from AFS to LAR <sup>(2)</sup> |                |            |                                       |                               |                                                                          |                                                                         |
| Debt securities                             | 167            | 90         | 7                                     | —                             | 7                                                                        | —                                                                       |
|                                             | 5,498          | 4,759      | (20)                                  | 21                            | 721                                                                      | 720                                                                     |

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

## Notes on the accounts

### 10 Financial instruments - classification continued

|                                             | Group                   |                     |                                          |                                           |                                                                                            | Reduction/<br>(increase) in<br>profit or loss<br>as a result of<br>reclassification<br>£m |
|---------------------------------------------|-------------------------|---------------------|------------------------------------------|-------------------------------------------|--------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|
|                                             | Carrying<br>value<br>£m | Fair<br>value<br>£m | Amount recognised in<br>income statement |                                           | Amount that<br>would have been<br>recognised had<br>reclassification<br>not occurred<br>£m |                                                                                           |
|                                             |                         |                     | Income<br>£m                             | Impairment<br>releases/<br>(losses)<br>£m |                                                                                            |                                                                                           |
| 2011                                        | £m                      | £m                  | £m                                       | £m                                        | £m                                                                                         | £m                                                                                        |
| Reclassified from HFT to LAR                |                         |                     |                                          |                                           |                                                                                            |                                                                                           |
| Loans                                       | 4,128                   | 3,305               | 157                                      | 18                                        | 297                                                                                        | 122                                                                                       |
| Debt securities                             | 2,268                   | 1,657               | 44                                       | (12)                                      | (255)                                                                                      | (287)                                                                                     |
|                                             | 6,396                   | 4,962               | 201                                      | 6                                         | 42                                                                                         | (165)                                                                                     |
| Reclassified from HFT to AFS <sup>(1)</sup> |                         |                     |                                          |                                           |                                                                                            |                                                                                           |
| Debt securities                             | 2,601                   | 2,601               | (4)                                      | 1                                         | 2                                                                                          | 5                                                                                         |
| Reclassified from AFS to LAR <sup>(2)</sup> |                         |                     |                                          |                                           |                                                                                            |                                                                                           |
| Debt securities                             | 248                     | 229                 | (11)                                     | (13)                                      | (24)                                                                                       | —                                                                                         |
|                                             | 9,245                   | 7,792               | 186                                      | (6)                                       | 20                                                                                         | (160)                                                                                     |

Notes:

(1) £51 million (2012 - £77 million; 2011 - £17 million) was taken to AFS reserves.

(2) £1 million (2012 - £1 million; 2011 - £24 million) would have been taken to AFS reserves if reclassification had not occurred.

The table below shows the carrying value and fair value of reclassifications undertaken by the Bank in 2008 and 2009.

|                                  | 2013                 |                  | Bank<br>2012         |                  | 2011                 |                  |
|----------------------------------|----------------------|------------------|----------------------|------------------|----------------------|------------------|
|                                  | Carrying value<br>£m | Fair value<br>£m | Carrying value<br>£m | Fair value<br>£m | Carrying value<br>£m | Fair value<br>£m |
| Reclassified from HFT to LAR     |                      |                  |                      |                  |                      |                  |
| Loans                            | 1,207                | 964              | 2,555                | 2,215            | 3,838                | 3,036            |
| Debt securities                  | 1,284                | 892              | 1,548                | 1,232            | 2,268                | 1,656            |
|                                  | 2,491                | 1,856            | 4,103                | 3,447            | 6,106                | 4,692            |
| Reclassified from HFT to AFS (1) |                      |                  |                      |                  |                      |                  |
| Debt securities                  | 62                   | 62               | 891                  | 891              | 2,601                | 2,601            |
| Reclassified from AFS to LAR (2) |                      |                  |                      |                  |                      |                  |
| Debt securities                  | —                    | —                | 167                  | 90               | 248                  | 229              |
|                                  | 2,553                | 1,918            | 5,161                | 4,428            | 8,955                | 7,522            |

Notes:

(1) £51 million (2012 - £77 million; 2011 - £17 million) was taken to AFS reserves.

(2) £1 million (2012 - £1 million; 2011 - £24 million) would have been taken to AFS reserves if reclassification had not occurred.

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## Notes on the accounts

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### 11 Financial instruments - valuation

#### Valuation of financial instruments carried at fair value

##### Control environment

Common valuation policies, procedures, frameworks and models apply across the Group.

The Group's control environment for the determination of the fair value of financial instruments includes formalised protocols for the review and validation of fair values independent of the businesses entering into the transactions. There are specific controls to ensure consistent pricing policies and procedures, incorporating disciplined price verification. The RBS Group ensures that appropriate attention is given to bespoke transactions, structured products, illiquid products and other instruments which are difficult to price.

A key element of the control environment is the independent price verification (IPV) process. Valuations are first performed by the business which entered into the transaction. Such valuations may be directly from available prices, or may be derived using a model and variable model inputs. These valuations are reviewed, and if necessary amended, by a team independent of those trading the financial instruments, in the light of available pricing evidence.

A new IPV quality hierarchy was implemented with detailed classifications linked to the fair value hierarchy principles as laid out in IFRS 13 'Fair value measurement'. The new hierarchy classifies IPV differences into fair value levels 1, 2 and 3 with the valuation uncertainty risk increasing as the levels rise from 1 to 3. These differences are then further classified into high, medium, low and indicative depending on the quality of the independent data available to validate the prices. Valuations are revised if they are outside agreed thresholds for each of the levels.

IPV is performed at a frequency to match the availability of independent data. For liquid instruments, the standard is to perform IPV daily. The minimum frequency of review in the Group is monthly for exposures in the regulatory trading book and quarterly for exposures in the regulatory banking book. Monthly meetings are held between the business and the support functions to discuss the results of the IPV and reserves. The IPV control includes formalised reporting and escalation of any valuation differences in breach of established thresholds. The Global Pricing Unit (GPU) determines IPV policy, monitors adherence to that policy and performs additional independent reviews on highly subjective valuation issues for Markets and Non-Core.

In 2013, the Group made a significant and ongoing investment into further enhancing its control environment. This included continuing investment in global IPV and reserving tools which partly automated the IPV and reserves process into a single central portal. System developments included implementing a rules based approach which ensures consistency across portfolios and the use of hierarchy of independent data inputs.

Valuation models are subject to a review process which requires different levels of model documentation, testing and review, depending on the complexity of the model and the size of the Group's exposure. A key element of the control environment for model use is a Modelled Product Review Committee, made up of valuations experts from several functions within the Group. This committee sets the policy for model documentation, testing and review, and prioritises models with significant exposure for review by the Group's Quantitative Research Centre (QuaRC). Potential valuation uncertainty is a key input in determining model review priorities at these meetings. The QuaRC team within Group Risk, which is independent of the trading businesses, assesses the appropriateness of the application of the model to the product, the mathematical robustness of the model, and where appropriate, considers alternative modelling approaches.

The Management Valuation Control Committees meet formally on a monthly basis to discuss independent pricing, reserving and valuation issues relating to both Markets and Non-Core exposures. All material methodology changes require review and ratification by these committees. The committees, which include valuation specialists representing several independent review functions, comprise Market Risk, QuaRC, Finance and senior business representatives.

The Executive Valuation Committee discusses the issues escalated by the Modelled Product Review Committee, Markets and Non-Core senior management Valuations Control Committee and other relevant issues. This committee covers key material and subjective valuation issues within the trading business and provides ratification to the appropriateness of areas with high levels of residual valuation uncertainty. Committee members include the RBS Group Finance Director, the RBS Group Chief Accountant, RBS Group Global Head of Market Risk, Markets Chief Financial Officer, the Non-Core Chief Financial Officer, the Head of QuaRC, the Head of GPU and representation from Front Office Trading and Finance.

Valuation issue, adjustments and reserves are reported to Markets, Non-Core and Group Audit Committees. Key judgmental issues are described in reports submitted to these Audit Committees.

Market risk metrics such as value-at-risk (VaR) and stressed value-at-risk (SVaR) cover financial instruments in Markets and Non-Core. The Group has a framework for quantify those market risks not adequately captured by standard market risk framework such as VaR and SVaR - Risks not in VaR. Refer to pages 161 to 167 for details.

##### New products

The Group has formal review procedures owned by Group Operational Risk to ensure that new products, asset classes and risk types are appropriately reviewed to ensure, amongst other things, that valuation is appropriate. The scope of this process includes new business, markets, models, risks and structures.

##### Valuation hierarchy

There is a process to review and control the classification of financial instruments into the three level hierarchy established by IFRS 13. Some instruments may not easily fall into a level of the fair value hierarchy and judgment may be required as to which level the instrument is classified.

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## Notes on the accounts

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### 11 Financial instruments - valuation continued

Initial classification of a financial instrument is carried out by the Business Unit Control team following the principles in IFRS. The Business Unit Control team base their judgment on information gathered during the IPV process for instruments which include the sourcing of independent prices and model inputs. The quality and completeness of the information gathered in the IPV process gives an indication as to the liquidity and valuation uncertainty of an instrument.

These initial classifications are reviewed and challenged by GPU and are also subject to senior management review. Particular attention is paid to instruments crossing from one level to another, new instrument classes or products, instruments that are generating significant profit and loss and instruments where valuation uncertainty is high.

#### Valuation techniques

The Group derives fair value of its instruments differently depending on whether the instrument is a non-modelled or a modelled product.

#### Non-modelled products

Non-modelled products are valued directly from a price input and are typically valued on a position by position basis and include cash, equities and most debt securities.

#### Modelled products

Modelled products are those that are valued using a pricing model, ranging in complexity from comparatively vanilla products such as interest rate swaps and options (e.g. interest rate caps and floors) through to more complex derivatives. The valuation of modelled products requires an appropriate model and inputs into this model. Sometimes models are also used to derive inputs (e.g. to construct volatility surfaces). The Group uses a number of modelling methodologies.

#### Inputs to valuation models

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

- Bond prices - quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads - where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.
- Interest rates - these are principally benchmark interest rates such as the London Interbank Offered Rate (LIBOR), Overnight Index Swaps rate (OIS) and other quoted interest rates in the swap, bond and futures markets.

- Foreign currency exchange rates - there are observable markets both for spot and forward contracts and futures in the world's major currencies.
- Equity and equity index prices - quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices - many commodities are actively traded in spot and forward contracts and futures on exchanges in London, New York and other commercial centres.
- Price volatilities and correlations - volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Volatility is a key input in valuing options and the valuation of certain products such as derivatives with more than one underlying variable that are correlation-dependent. Volatility and correlation values are obtained from broker quotations, pricing services or derived from option prices.
- Prepayment rates - the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets, the Group considers the value of the prepayment option.
- Counterparty credit spreads - adjustments are made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price (or parameters).
- Recovery rates/loss given default - these are used as an input to valuation models and reserves for asset-backed securities and other credit products as an indicator of severity of losses on default. Recovery rates are primarily sourced from market data providers or inferred from observable credit spreads.

The Group may use consensus prices for the source of independent pricing for some assets. The consensus service encompasses the equity, interest rate, currency, commodity, credit, property, fund and bond markets, providing comprehensive matrices of vanilla prices and a wide selection of exotic products. Markets and Non-Core contribute to consensus pricing services where there is a significant interest either from a positional point of view or to test models for future business use. Data sourced from consensus pricing services is used for a combination of control processes including direct price testing, evidence of observability and model testing. In practice this means that the Group submits prices for all material positions for which a service is available. Data from consensus services are subject to the same level of quality review as other inputs used for IPV process.

## Notes on the accounts

### 11 Financial instruments - valuation continued

In order to determine a reliable fair value, where appropriate, management applies valuation adjustments to the pricing information gathered from the above sources. The sources of independent data are reviewed for quality and are applied in the IPV process using a formalised input quality hierarchy. These adjustments reflect the Group's assessment of factors that market participants would consider in setting a price. Furthermore, on an ongoing basis, the Group assesses the appropriateness of any model used. To the extent that the price provided by internal models does not represent the fair value of the instrument, for instance in highly stressed market conditions, the Group makes adjustments to the model valuation to calibrate to other available pricing sources. Where unobservable inputs are used, the Group may determine a range of possible valuations derived from differing stress scenarios to determine the sensitivity associated with the valuation.

When establishing the fair value of a financial instrument using a valuation technique, the Group considers certain adjustments to the modelled price which market participants would make when pricing that instrument. Such adjustments include the credit quality of the counterparty and adjustments to compensate for any known model limitations.

|                                                                    | 2013<br>£m   | 2012<br>£m   | 2011<br>£m   |
|--------------------------------------------------------------------|--------------|--------------|--------------|
| <b>Credit valuation adjustments</b>                                |              |              |              |
| - monoline insurers and credit derivative product companies (CDPC) | 93           | 495          | 2,046        |
| - other counterparties                                             | 1,635        | 2,069        | 1,609        |
|                                                                    | 1,728        | 2,564        | 3,655        |
| <b>Other valuation reserves</b>                                    |              |              |              |
| - bid-offer                                                        | 512          | 621          | 787          |
| - funding valuation adjustment                                     | 424          | 475          | 552          |
| - product and deal specific                                        | 745          | 758          | 1,023        |
| - other                                                            | 8            | 126          | 290          |
|                                                                    | 1,689        | 1,980        | 2,652        |
| <b>Valuation reserves</b>                                          | <b>3,417</b> | <b>4,544</b> | <b>6,307</b> |

#### Monoline insurers

The Group's exposure to monolines is predominately credit default swaps (CDSs) referencing ABS held directly or synthetically.

For the majority of trades the gross mark-to-market of the monoline protection is determined directly from the fair value price of the underlying reference instrument. However, for the remainder of the trades the gross mark-to-market is determined using industry standard models.

The CVA methodology uses market implied probability of defaults and internally assessed recovery rates to determine the level of expected loss on monoline exposures of different maturities. The probability of default is calculated with reference to market observable credit spreads and recovery levels. CVA is calculated at a trade level by applying the expected loss corresponding to each trade's expected maturity, to the gross mark-to-market of the monoline protection. The expected maturity of each trade reflects the scheduled notional amortisation of the underlying reference instruments and whether payments due from the monoline are received at the point of default or over the life of the underlying reference instruments.

### Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. The following table shows the Group's credit valuation adjustments and other reserves. The valuation framework used to determine the fair value of uncollateralised derivative exposures was refined during the year in line with market developments. The weightings applied to the expected losses and gains in the credit valuation adjustments (CVA) and own credit adjustments (OCA) calculations have been removed. Funding valuation adjustments (FVA) now reflect the counterparty contingent nature of the exposures. FVA is also now considered the primary adjustment applied to liabilities; the extent to which OCA and FVA overlap is eliminated from OCA. The following table shows CVA and other valuation reserves.

#### Credit valuation adjustments

Credit valuation adjustments (CVA) represent an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.

#### Credit derivative product companies (CDPC)

A CDPC is a company that sells protection on credit derivatives. CDPCs are similar to monoline insurers, however they are not regulated as insurers. The Group's exposure to CDPCs is predominantly due to tranching credit derivatives ("tranches"). A tranche references a portfolio of loans and bonds and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point).

The gross mark-to-market of the CDPC protection is determined using industry standard models. The table above includes valuation adjustments of £34 million relating to certain CDPCs which reflect trade restructuring levels of similar exposures in 2012. For trades facing other CDPCs, the CVA methodology is different to that outlined above for monolines, as there are no market observable credit spreads and recovery levels for these entities. The level of expected loss on these CDPC exposures is estimated with reference to risk mitigation strategies.



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## Notes on the accounts

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### 11 Financial instruments - valuation continued

#### Other counterparties

The CVA for all other counterparties is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Potential future exposures arising from vanilla products (including interest rate and foreign exchange derivatives) are modelled jointly using the Group's core counterparty risk systems. The majority of the Group's CVA held in relation to other counterparties arises on these vanilla products together with exposures to counterparties which are considered to be close to default. The exposures arising from all other product types are modelled and assessed individually. The potential future positive exposure to each counterparty is the aggregate of the exposures arising on the underlying product types.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities. Weightings that were previously applied in the expected losses calculation were removed during 2013 in line with market developments.

The correlation between exposure and counterparty risk is also incorporated within the CVA calculation where this risk is considered significant. The risk primarily arises on credit derivative trades where the default risk of the referenced entity is correlated with the counterparty risk. The risk also arises on trades with emerging market counterparties where the gross mark-to-market value of the trade, and therefore the counterparty exposure, increases as the strength of the local currency declines.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where the Group holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

#### Bid-offer and liquidity reserves

Fair value positions are adjusted to bid or offer levels, by marking individual cash based positions directly to bid or offer or by taking bid-offer reserves calculated on a portfolio basis for derivatives exposures. The bid-offer approach is based on current market spreads and standard market bucketing of risk.

Risk data are used as the primary sources of information within bid-offer calculations and are aggregated when they are more granular than market standard buckets. Bid-offer adjustments for each risk factor (including delta (the degree to which the price of an instrument changes in response to a change in the price of the underlying), vega (the degree to which the price of an instrument changes in response to the volatility in the price of the underlying), correlation (the degree to which prices of different instruments move together) and others) are determined by aggregating similar risk exposures arising on different products. Additional basis bid-offer reserves are taken where these are charged in the market. Risk associated with non-identical underlying exposures is not netted down unless there is evidence that the cost of closing the combined risk exposure is less than the cost of closing on an individual basis.

Bid-offer spreads vary by maturity and risk type to reflect different spreads in the market. For positions where there is no observable quote, the bid-offer spreads are widened in comparison to proxies to reflect reduced liquidity or observability. Bid-offer methodologies also incorporate liquidity triggers whereby wider spreads are applied to risks above pre-defined thresholds.

As permitted by IFRS 13, netting is applied on a portfolio basis to reflect the level at which the Group believes it could exit the portfolio, rather than the sum of exit costs for each of the portfolio's individual trades. For example, netting is applied where long and short risk in two different maturity buckets can be closed out in a single market transaction at less cost than by way of two separate transactions (calendar netting). This reflects the fact that to close down the portfolio, the net risk can be settled rather than each long and short trade individually.

Vanilla risk on exotic products is typically reserved as part of the overall portfolio based calculation e.g. delta and vega risk on exotic products are included within the delta and vega bid-offer calculations. Aggregation of risk arising from different models is in line with the Group's risk management practices; the model review control process considers the appropriateness of model selection in this respect.

Product related risks such as correlation risk, attract specific bid-offer reserves. Additional reserves are provided for exotic products to ensure overall reserves match market close-out costs. These market close-out costs inherently incorporate risk decay and cross-effects (taking into account how moves in one risk factor may affect other inputs rather than treating all risk factors independently) that are unlikely to be adequately reflected in a static hedge based on vanilla instruments. Where there is limited bid-offer information for a product, the pricing approach and risk management strategy are taken into account when assessing the reserve.

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivatives are generally discounted at the relevant OIS rates at an individual trade level. Uncollateralised derivatives are discounted with reference to funding levels by applying a funding spread over benchmark interest rates on a portfolio basis (funding valuation adjustment).

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Funding valuation adjustment (FVA)

Funding valuation adjustments represent an estimate of the adjustment to fair value that a market participant would make to incorporate funding costs and benefits that arise in relation to uncollateralised derivative exposures.

Funding levels are applied to estimated potential future exposures, the modelling of which is consistent with the approach used in the calculation of CVA relating to Other counterparties. The counterparty contingent nature of the exposures is now reflected in the calculation.

#### Amounts deferred on initial recognition

On initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data becomes observable; or when the transaction matures or is closed out as appropriate. At 31 December 2013, net gains of £205 million (2012 - £150 million; 2011 - £156 million) were carried forward. During the year, net gains of £137 million (2012 - £38 million; 2011 - £87 million) were deferred and £82 million (2012 - £44 million; 2011 - £87 million) recognised in the income statement.

#### Own credit

The Group takes into account the effect of its own credit standing when valuing financial liabilities recorded at fair value in accordance with IFRS. Own credit spread adjustments are made to issued debt held at fair value, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes this adjustment is based on debt issuance spreads above average inter-bank rates (at a range of tenors). Secondary senior debt issuance spreads are used in the calculation of the own credit adjustment applied to senior debt.

The fair value of the Group's derivative financial liabilities has also been adjusted to reflect the Group's own credit risk (DVA). Expected gains are applied to estimated potential future negative exposures, the modelling of which is consistent with the approach used in calculation of CVA relating to Other counterparties. Expected gains are determined from market implied probabilities of default and recovery levels. Weightings that were previously applied in the expected gains calculation were removed during the period in line with market developments. FVA is also now considered the primary adjustment applied to derivative liabilities; the extent to which DVA and FVA overlap is eliminated from DVA.

The own credit adjustment for fair value does not alter cash flows, is not used for performance management, is disregarded for regulatory capital reporting processes and will reverse over time as the liabilities mature.

The reserve movement between periods will not equate to the reported profit or loss for own credit. The balance sheet reserves are stated by conversion of underlying currency balances at spot rates for each period whereas the income statement includes intra-period foreign exchange sell-offs and excludes the impact of the methodology refinements relating to derivative financial liabilities. The methodology refinements also related to other valuation adjustments, and the impact of the refinements was reported as part of the reported profit or loss for the other valuation adjustments.

The effect of change in credit spreads could be reversed in future periods, provided the liability is not repaid at a premium or a discount.

The cumulative own credit adjustment (OCA) recorded on securities held-for-trading (HFT), designated as at fair value through profit or loss (DFV) and derivative liabilities are set out below.

| Cumulative own credit adjustment (CR)/DR (1) | Debt securities in issue (1) |           |             | Subordinated Liabilities |             | Derivatives | Total |
|----------------------------------------------|------------------------------|-----------|-------------|--------------------------|-------------|-------------|-------|
|                                              | HFT<br>£m                    | DFV<br>£m | Total<br>£m | DFV<br>£m                | Total<br>£m |             |       |
| 2013                                         | (467)                        | (23)      | (490)       | 67                       | (423)       | 76          | (347) |
| 2012                                         | (648)                        | 41        | (607)       | 104                      | (503)       | 240         | (263) |
| 2011                                         | 882                          | 1,995     | 2,877       | 241                      | 3,118       | 540         | 3,658 |

#### Carrying values of underlying liabilities

|      | £bn  | £bn  | £bn  | £bn | £bn  |
|------|------|------|------|-----|------|
| 2013 | 8.6  | 15.0 | 23.6 | 0.4 | 24.0 |
| 2012 | 10.8 | 22.2 | 33.0 | 0.5 | 33.5 |
| 2011 | 11.4 | 26.8 | 38.2 | 0.5 | 38.7 |

Note:

(1) Consists of wholesale and retail note issuances.

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Valuation hierarchy

The following tables show financial instruments carried at fair value on the Group's balance sheet by valuation hierarchy - level 1, level 2 and level 3.

|                                       | 2013           |                |                |              | 2012           |                |                |              | 2011           |                |                |              |
|---------------------------------------|----------------|----------------|----------------|--------------|----------------|----------------|----------------|--------------|----------------|----------------|----------------|--------------|
|                                       | Level 1<br>£bn | Level 2<br>£bn | Level 3<br>£bn | Total<br>£bn | Level 1<br>£bn | Level 2<br>£bn | Level 3<br>£bn | Total<br>£bn | Level 1<br>£bn | Level 2<br>£bn | Level 3<br>£bn | Total<br>£bn |
| <b>Assets</b>                         |                |                |                |              |                |                |                |              |                |                |                |              |
| Loans and advances to banks           | —              | 38.5           | 0.3            | 38.8         | —              | 49.4           | 0.4            | 49.8         | —              | 66.8           | 0.4            | 67.2         |
| Loans and advances to customers       | —              | 68.6           | 0.2            | 68.8         | —              | 94.2           | 0.5            | 94.7         | —              | 78.2           | 0.4            | 78.6         |
| <b>Debt securities</b>                |                |                |                |              |                |                |                |              |                |                |                |              |
| UK government                         | 13.2           | —              | —              | 13.2         | 15.6           | —              | —              | 15.6         | 19.7           | —              | —              | 19.7         |
| US government                         | 16.8           | 5.6            | —              | 22.4         | 29.4           | 5.4            | —              | 34.8         | 32.6           | 5.0            | —              | 37.6         |
| Other government                      | 24.7           | 4.6            | 0.1            | 29.4         | 32.4           | 4.0            | —              | 36.4         | 46.1           | 3.0            | —              | 49.1         |
| Corporate                             | —              | 1.8            | 0.3            | 2.1          | —              | 1.9            | 0.1            | 2.0          | 0.1            | 2.6            | 0.5            | 3.2          |
| Financial institutions                | 1.4            | 26.8           | 1.7            | 29.9         | 2.5            | 36.2           | 4.8            | 43.5         | 2.7            | 44.4           | 7.0            | 54.1         |
|                                       | 56.1           | 38.8           | 2.1            | 97.0         | 79.9           | 47.5           | 4.9            | 132.3        | 101.2          | 55.0           | 7.5            | 163.7        |
| <b>Of which ABS</b>                   |                |                |                |              |                |                |                |              |                |                |                |              |
| RMBS (1)                              | —              | 20.4           | 0.3            | 20.7         | —              | 27.9           | 0.9            | 28.8         | —              | 35.0           | 0.6            | 35.6         |
| CMBS (2)                              | —              | 3.7            | —              | 3.7          | —              | 3.8            | —              | 3.8          | —              | 2.1            | 0.1            | 2.2          |
| CDO (3)                               | —              | —              | 0.4            | 0.4          | —              | —              | 0.6            | 0.6          | —              | —              | 1.7            | 1.7          |
| CLO (4)                               | —              | 0.4            | 0.7            | 1.1          | —              | 0.5            | 2.4            | 2.9          | —              | 1.2            | 3.7            | 4.9          |
| Other                                 | —              | 1.5            | 0.3            | 1.8          | —              | 1.6            | 0.4            | 2.0          | —              | 2.0            | 0.9            | 2.9          |
| Equity shares                         | 6.9            | 1.0            | 0.4            | 8.3          | 12.3           | 1.1            | 0.5            | 13.9         | 10.2           | 1.0            | 0.6            | 11.8         |
| Derivatives                           | 0.1            | 285.7          | 3.6            | 289.4        | 0.4            | 440.8          | 3.9            | 445.1        | 0.2            | 525.8          | 6.8            | 532.8        |
|                                       | 63.1           | 432.6          | 6.6            | 502.3        | 92.6           | 633.0          | 10.2           | 735.8        | 111.6          | 726.8          | 15.7           | 854.1        |
| Proportion                            | 12.6%          | 86.1%          | 1.3%           | 100.0%       | 12.6%          | 86.0%          | 1.4%           | 100.0%       | 13.1%          | 85.1%          | 1.8%           | 100.0%       |
| <b>Of which is classified AFS (5)</b> |                |                |                |              |                |                |                |              |                |                |                |              |
| <b>Debt securities</b>                |                |                |                |              |                |                |                |              |                |                |                |              |
| UK government                         | 6.4            | —              | —              | 6.4          | 8.0            | —              | —              | 8.0          | 10.7           | —              | —              | 10.7         |
| US government                         | 6.7            | 4.8            | —              | 11.5         | 14.0           | 3.5            | —              | 17.5         | 16.1           | 2.7            | —              | 18.8         |
| Other government                      | 5.2            | 1.6            | —              | 6.8          | 8.7            | 1.4            | —              | 10.1         | 13.8           | 0.3            | —              | 14.1         |
| Corporate                             | —              | 0.1            | 0.1            | 0.2          | —              | —              | 0.1            | 0.1          | —              | 0.2            | 0.2            | 0.4          |
| Financial institutions                | 0.7            | 14.0           | 1.1            | 15.8         | 0.5            | 15.5           | 2.9            | 18.9         | —              | 21.9           | 5.5            | 27.4         |
|                                       | 19.0           | 20.5           | 1.2            | 40.7         | 31.2           | 20.4           | 3.0            | 54.6         | 40.6           | 25.1           | 5.7            | 71.4         |
| <b>Of which AFS ABS</b>               |                |                |                |              |                |                |                |              |                |                |                |              |
| RMBS                                  | —              | 11.9           | 0.1            | 12.0         | —              | 12.8           | 0.2            | 13.0         | —              | 17.9           | 0.2            | 18.1         |
| CMBS                                  | —              | 3.1            | —              | 3.1          | —              | 2.3            | —              | 2.3          | —              | 0.7            | —              | 0.7          |
| CDO                                   | —              | —              | 0.3            | 0.3          | —              | —              | 0.5            | 0.5          | —              | —              | 1.4            | 1.4          |
| CLO                                   | —              | —              | 0.6            | 0.6          | —              | 0.3            | 1.9            | 2.2          | —              | 0.7            | 3.3            | 4.0          |
| Other                                 | —              | 0.9            | 0.1            | 1.0          | —              | 0.8            | 0.2            | 1.0          | —              | 1.1            | 0.7            | 1.8          |
| Equity shares                         | 0.2            | 0.6            | 0.2            | 1.0          | 0.2            | 0.7            | 0.1            | 1.0          | 0.3            | 0.8            | 0.2            | 1.3          |
| Total AFS assets (5)                  | 19.2           | 21.1           | 1.4            | 41.7         | 31.4           | 21.1           | 3.1            | 55.6         | 40.9           | 25.9           | 5.9            | 72.7         |
| <b>Liabilities</b>                    |                |                |                |              |                |                |                |              |                |                |                |              |
| Deposits by banks and customers       | —              | 110.1          | 0.2            | 110.3        | —              | 168.0          | —              | 168.0        | —              | 147.2          | —              | 147.2        |
| Debt securities in issue              | —              | 22.3           | 1.3            | 23.6         | —              | 31.7           | 1.3            | 33.0         | —              | 36.4           | 1.8            | 38.2         |
| Short positions                       | 23.9           | 4.1            | —              | 28.0         | 23.6           | 4.0            | —              | 27.6         | 34.1           | 6.1            | 0.2            | 40.4         |
| Derivatives                           | 0.1            | 282.9          | 3.1            | 286.1        | 0.8            | 431.8          | 3.5            | 436.1        | 0.4            | 523.4          | 4.0            | 527.8        |
| Subordinated liabilities              | —              | 0.4            | —              | 0.4          | —              | 0.5            | —              | 0.5          | —              | 0.5            | —              | 0.5          |
|                                       | 24.0           | 419.8          | 4.6            | 448.4        | 24.4           | 636.0          | 4.8            | 665.2        | 34.5           | 713.6          | 6.0            | 754.1        |
| Proportion                            | 5.4%           | 93.6%          | 1.0%           | 100.0%       | 3.7%           | 95.6%          | 0.7%           | 100.0%       | 4.6%           | 94.6%          | 0.8%           | 100.0%       |

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

## Notes on the accounts

### 11 Financial instruments - valuation continued

The following table analyses level 3 balances and related sensitivities.

|                                 | 2013           |                  |                    | 2012           |                  |                    | 2011           |                  |                    |
|---------------------------------|----------------|------------------|--------------------|----------------|------------------|--------------------|----------------|------------------|--------------------|
|                                 | Balance<br>£bn | Sensitivity (6)  |                    | Balance<br>£bn | Sensitivity (6)  |                    | Balance<br>£bn | Sensitivity (6)  |                    |
|                                 |                | Favourable<br>£m | Unfavourable<br>£m |                | Favourable<br>£m | Unfavourable<br>£m |                | Favourable<br>£m | Unfavourable<br>£m |
| Assets                          |                |                  |                    |                |                  |                    |                |                  |                    |
| Loans and advances to banks     | 0.3            | 30               | (10)               | 0.4            | 50               | (30)               | 0.4            | 40               | (50)               |
| Loans and advances to customers | 0.2            | 20               | (30)               | 0.5            | 90               | (40)               | 0.4            | 80               | (20)               |
| Debt securities                 |                |                  |                    |                |                  |                    |                |                  |                    |
| Other government                | 0.1            | —                | —                  | —              | —                | —                  | —              | —                | —                  |
| Corporate                       | 0.3            | 20               | (10)               | 0.1            | 10               | (10)               | 0.5            | 30               | (30)               |
| Financial institutions          | 1.7            | 130              | (100)              | 4.8            | 350              | (190)              | 7.0            | 510              | (140)              |
|                                 | 2.1            | 150              | (110)              | 4.9            | 360              | (200)              | 7.5            | 540              | (170)              |
| Of which ABS                    |                |                  |                    |                |                  |                    |                |                  |                    |
| RMBS                            | 0.3            | 30               | (30)               | 0.9            | 40               | (50)               | 0.6            | 60               | (40)               |
| CMBS                            | —              | —                | —                  | —              | —                | —                  | 0.1            | 10               | —                  |
| CDO                             | 0.4            | 40               | (10)               | 0.6            | 80               | (10)               | 1.7            | 210              | (20)               |
| CLO                             | 0.7            | 30               | (30)               | 2.4            | 120              | (50)               | 3.7            | 90               | (40)               |
| other                           | 0.3            | 20               | (20)               | 0.4            | 50               | (10)               | 0.9            | 110              | (20)               |
| Equity shares                   | 0.4            | 70               | (60)               | 0.5            | 70               | (80)               | 0.6            | 80               | (90)               |
| Derivatives                     |                |                  |                    |                |                  |                    |                |                  |                    |
| Credit                          | 0.8            | 70               | (110)              | 1.6            | 230              | (230)              | 3.8            | 670              | (390)              |
| Other                           | 2.8            | 310              | (150)              | 2.3            | 420              | (300)              | 3.0            | 180              | (190)              |
|                                 | 3.6            | 380              | (260)              | 3.9            | 650              | (530)              | 6.8            | 850              | (580)              |
|                                 | 6.6            | 650              | (470)              | 10.2           | 1,220            | (880)              | 15.7           | 1,590            | (910)              |
| Liabilities                     |                |                  |                    |                |                  |                    |                |                  |                    |
| Deposits                        | 0.2            | —                | (10)               | —              | 30               | (30)               | —              | 20               | (20)               |
| Debt securities in issue        | 1.3            | 40               | (60)               | 1.3            | 50               | (60)               | 1.8            | 50               | (30)               |
| Short positions                 | —              | —                | —                  | —              | —                | —                  | 0.2            | 10               | (30)               |
| Derivatives                     |                |                  |                    |                |                  |                    |                |                  |                    |
| Credit                          | 1.0            | 40               | (60)               | 0.8            | 40               | (90)               | 1.7            | 370              | (170)              |
| Other                           | 2.1            | 90               | (60)               | 2.7            | 110              | (70)               | 2.3            | 140              | (140)              |
|                                 | 3.1            | 130              | (120)              | 3.5            | 150              | (160)              | 4.0            | 510              | (310)              |
|                                 | 4.6            | 170              | (190)              | 4.8            | 230              | (250)              | 6.0            | 590              | (390)              |

**Notes:**

- (1) Residential mortgage-backed securities.
- (2) Commercial mortgage-backed securities.
- (3) Collateralised debt obligations.
- (4) Collateralised loan obligations.
- (5) Available-for-sale.
- (6) Sensitivity represents the favourable and unfavourable effect on the income statement or the statement of comprehensive income due to reasonably possible changes to valuations using reasonably possible alternative inputs in the Group's valuation techniques or models. Level 3 sensitivities are calculated at a sub-portfolio level and hence these aggregated figures do not reflect the correlation between some of the sensitivities. In particular, for some portfolios, the sensitivities may be negatively correlated where a downward movement in one asset would produce an upward movement in another, but due to the additive presentation above, this correlation cannot be shown.
- (7) Transfers between levels are deemed to have occurred at the beginning of the quarter in which the instruments were transferred.
- (8) Level 1: valued using unadjusted quoted prices in active markets, for identical financial instruments. Examples include G10 government securities, listed equity shares, certain exchange-traded derivatives and certain US agency securities.  
Level 2: valued using techniques based significantly on observable market data. Instruments in this category are valued using;  
(a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or  
(b) valuation techniques where all the inputs that have a significant effect on the valuations are directly or indirectly based on observable market data.

The type of instruments that trade in markets that are not considered to be active, but are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and those instruments valued using techniques include non-G10 government securities, most government agency securities, investment-grade corporate bonds, certain mortgage products, including CLOs, most bank loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most notes issued and certain money market securities and loan commitments and most OTC derivatives.

Level 3: Instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation, is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input. Financial instruments primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, certain emerging markets instruments, unlisted equity shares, certain residual interests in securitisations, the majority of CDOs, other mortgage-backed products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

- (9) Improvements in IPV methodology resulted in £0.4 billion assets and £0.5 billion liabilities, principally derivatives transfers from level 3 to level 2. Transfers from level 2 to level 3 comprised: derivatives (assets £0.9 billion and liabilities £0.5 billion), debt securities in issue of £0.2 billion and debt securities £0.2 billion relating to securities, primarily ABS, in Non-Core. Market illiquidity towards the end of June was a major cause for the transfers. There were no significant transfers between level 1 and level 2.

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Valuation techniques

The table below shows a breakdown of valuation techniques and the ranges for those unobservable inputs used in valuation models and techniques that have a material impact on the valuation of Level 3 financial instruments. The table excludes unobservable inputs where the impact on valuation is less significant. Movements in the underlying input may have a favourable or unfavourable impact on the valuation depending on the particular terms of the contract and the exposure. For example an increase in the credit spread of a bond would be favourable for the issuer and unfavourable for the note holder. Whilst we indicate where we consider that there are significant relationships between the inputs, these inter-relationships will be affected by macro economic factors including interest rates, foreign exchange rates or equity index levels.

| Financial instruments | Level 3 (£bn) |             | Valuation technique                  | Unobservable inputs                    | Range |        |
|-----------------------|---------------|-------------|--------------------------------------|----------------------------------------|-------|--------|
|                       | Assets        | Liabilities |                                      |                                        | Low   | High   |
| Loans                 | 0.5           | —           | Price based                          | Price (2)                              | 80%   | 100%   |
|                       |               |             | Discounted cash flow model (DCF)     | Credit spreads (3)                     | 0bps  | 831bps |
|                       |               |             |                                      | Recovery rates (4)                     | 10%   | 67%    |
|                       |               |             |                                      | Yield (2)                              | 8%    | 24%    |
|                       |               |             |                                      | Probability of default (5)             | 5%    | 20%    |
| Deposits              |               | 0.2         | Option pricing                       | Volatility (6)                         | 27%   | 30%    |
| Debt securities       |               |             |                                      |                                        |       |        |
| RMBS                  | 0.3           |             | Price based                          | Price (2)                              | 0%    | 96%    |
|                       |               |             | DCF                                  | Probability of default (5)             | 2%    | 7%     |
|                       |               |             |                                      | Conditional prepayment rates (CPR) (7) | 0%    | 7%     |
|                       |               |             |                                      | Yield (2)                              | 6%    | 19%    |
| CDO and CLO           | 1.1           |             | Price based                          | Price (2)                              | 0%    | 100%   |
|                       |               |             | DCF                                  | Yield (2)                              | 10%   | 29%    |
|                       |               |             |                                      | Probability of default (5)             | 2%    | 11%    |
| Other ABS             | 0.3           |             | Price based                          | Price (2)                              | 0%    | 100%   |
| Other debt securities | 0.4           |             | DCF                                  | Credit spreads (3)                     | 99bps | 140bps |
|                       |               |             | Price based                          | Price (2)                              | 68%   | 100%   |
| Equity securities     | 0.4           |             | Price based                          | Price (2)                              | 69%   | 158%   |
|                       |               |             | EBITDA multiple                      | EBITDA multiple (8)                    | 1x    | 40x    |
|                       |               |             | DCF                                  | Yield                                  | 47%   | 64%    |
|                       |               |             |                                      | Recovery rates (4)                     | 0%    | 40%    |
| Derivatives           |               |             |                                      |                                        |       |        |
| Credit                | 0.8           | 1.0         | Price based                          | Price (2)                              | 0%    | 100%   |
|                       |               |             | DCF based on defaults and recoveries | Recovery rates (4)                     | 0%    | 100%   |
|                       |               |             |                                      | Upfront points (9)                     | 2%    | 100%   |
|                       |               |             |                                      | Credit spreads (3)                     | 35bps | 725bps |
| Other                 | 2.8           | 2.1         | DCF                                  | Correlation (10)                       | (55%) | 100%   |
|                       |               |             |                                      | CPR (7)                                | 2%    | 20%    |
|                       |               |             | Option pricing model                 | Volatility (6)                         | 6%    | 40%    |
|                       |               |             |                                      | Correlation (10)                       | (55%) | 100%   |

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

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## Notes on the accounts

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### 11 Financial instruments - valuation continued

#### Notes:

- (1) Level 3 structured issued debt securities of £1.3 billion are not included in the table above as valuation is consistent with the valuation of the embedded derivative component.
- (2) Price and yield: There may be a range of price based information used for evaluating the value of an instrument. This may be a direct comparison of one instrument or portfolio with another or movements in a more liquid instrument may be used to indicate the movement in the value of less liquid instrument. The comparison may also be indirect in that adjustments are made to the price to reflect differences between the pricing source and the instrument being valued, for example different maturity, credit quality, seniority or expected payouts. Similarly to price, an instrument's yield may be compared to other instruments either directly or indirectly. Prices move inversely to yields.
- (3) Credit spreads and discount margins: Credit spreads and margins express the return required over a benchmark rate or index to compensate for the credit risk associated with a cash instrument. A higher credit spread would indicate that the underlying instrument has more credit risk associated with it. Consequently, investors require a higher yield to compensate for the higher risk. The discount rate comprises credit spread or margin plus the benchmark rate; it is used to value future cash flows.
- (4) Recovery rate: Reflects market expectations about the return of principal for a debt instrument or other obligations after a credit event or on liquidation. Recovery rates tend to move conversely to credit spreads.
- (5) Probability of default: This is a measure of the expected rate of losses in an underlying portfolio of mortgages or other receivables. The higher the probability of default the lower the value of the underlying portfolio. The cumulative losses tend to move conversely to prepayment rates and in line with constant default rates. The higher the rate, the higher the expected number of defaults and therefore the expected losses. An increase in the default rate is likely to reduce the value of an asset.
- (6) Volatility: A measure of the tendency of a price to change with time.
- (7) Conditional prepayment rate: The measure of the rate at which underlying mortgages or loans are prepaid. An increase in prepayment rates in a portfolio may increase or decrease its value depending upon the credit quality and payment terms of the underlying loans. For example an increase in prepayment rate of a portfolio of high credit quality underlying assets may reduce the value and size of the portfolio whereas for lower credit quality underlyings it may increase the value.
- (8) EBITDA (earnings before interest, tax, depreciation and amortisation) multiple: This is a commonly used valuation technique for equity holdings. The EBITDA of a company is used as a proxy for the future cash flows and when multiplied by an appropriate factor gives an estimate for the value of the company.
- (9) Upfront points: These are similar to credit spreads in that a higher figure is a measure of increased credit risk. A credit derivative price can be quoted on either credit spread or upfront points basis and the two can be considered a near equivalent from a risk perspective. As with credit spreads higher upfront points indicate that the underlying entity has a higher credit risk associated with it.
- (10) Correlation: Measures the degree by which two prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Correlations typically include relationships between: default probabilities of assets in a basket (a group of separate assets), exchange rates, interest rates and other financial variables.
- (11) The Group does not have any material liabilities measured at fair value that are issued with an inseparable third party credit enhancement.

Level 3 sensitivities are calculated at a trade or low level portfolio basis. They are not calculated on an overall portfolio basis and therefore do not reflect the likely overall potential uncertainty on the whole portfolio. The figures are aggregated and do not reflect the correlated nature of some of the sensitivities. In particular, for some of the portfolios the sensitivities may be negatively correlated where a downwards movement in one asset would produce an upwards movement in another, but due to the additive presentation of the above figures this correlation cannot be observed. The actual potential downside sensitivity of the total portfolio may be less than the non-correlated sum of the additive figures as shown in the above table.

#### Judgmental issues

The diverse range of products traded by the Group results in a wide range of instruments that are classified into the three level hierarchy. Whilst the majority of these instruments naturally fall into a particular level, for some products an element of judgment is required. The majority of the Group's financial instruments carried at fair value are classified as level 2: inputs are observable either directly (i.e. as a price) or indirectly (i.e. derived from prices).

#### Active and inactive markets

A key input in the decision making process for the allocation of assets to a particular level is liquidity. In general, the degree of valuation uncertainty depends on the degree of liquidity of an input. For example, a derivative can be placed into level 2 or level 3 dependent upon the liquidity of level 3 inputs.

Where markets are liquid or very liquid, little judgment is required. However, when the information regarding the liquidity in a particular market is not clear, a judgment may need to be made. This can be made more difficult as assessing the liquidity of a market may not always be straightforward. For an equity traded on an exchange, daily volumes of trading can be seen, but for an over-the-counter (OTC) derivative assessing the liquidity of the market with no central exchange can be more difficult.

A key related issue is where a market moves from liquid to illiquid or vice versa. Where this change is considered to be temporary, the classification is not changed. For example, if there is little market trading in a product on a reporting date but at the previous reporting date and during the intervening period the market has been considered to be liquid, the instrument will continue to be classified in the same level in the hierarchy. This is to provide consistency so that transfers between levels are driven by genuine changes in market liquidity and do not reflect short term or seasonal effects.

#### Interaction with the IPV process

The determination of an instrument's level cannot be made at a global product level as a single product type can be in more than one level. For example, a single name corporate credit default swap could be in level 2 or level 3 depending on whether the reference counterparty is liquid or illiquid.

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## Notes on the accounts

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### 11 Financial instruments - valuation continued

The breadth and depth of this data allows a rules based quality assessment to be made of market activity, liquidity and pricing uncertainty, which assists with the process of allocation to an appropriate level. Where suitable independent pricing information is not readily available, the quality assessment will result in the instrument to be considered as level 3.

As part of the Group's IPV process, data are gathered at a trade level from market trading activity, trading systems, pricing services, consensus pricing providers, brokers and research material amongst other sources.

#### Modelled products

For modelled products the market convention is to quote these trades through the model inputs or parameters as opposed to a cash price equivalent. A mark-to-market is derived from the use of the independent market inputs calculated using the Group's model.

The decision to classify a modelled asset as level 2 or 3 will be dependent upon the product/model combination, the currency, the maturity, the observability of input parameters and other factors. All these need to be assessed to classify the asset.

An assessment is made of each input into a model. There may be multiple inputs into a model and each is assessed in turn for observability and quality. As part of the process of classifying the quality of IPV results the IPV quality classifications have been designed to follow the accounting level classifications, although with a further level of granularity. For example there are a number of different IPV quality levels that equate to a level 2 classification and so on.

If an input fails the observability or quality tests then the instrument is considered to be in level 3 unless the input can be shown to have an insignificant effect on the overall valuation of the product.

The majority of derivative instruments are classified as level 2 as they are vanilla products valued using observable inputs. The valuation uncertainty on these is considered to be low and both input and output testing may be available. Examples of these products would be vanilla interest rate swaps, foreign exchange swaps and liquid single name credit derivatives.

#### Non-modelled products

Non-modelled products are generally quoted on a price basis and can therefore be considered for each of the 3 levels. This is determined by the market activity, liquidity and valuation uncertainty of the instruments which is in turn measured from the availability of independent data used by the IPV process to allocate positions to IPV quality levels.

The availability and quality of independent pricing information is considered during the classification process. An assessment is made regarding the quality of the independent information. For example where consensus prices are used for non-modelled products, a key assessment of the quality of a price is the depth of the number of prices used to provide the consensus price. If the depth of contributors falls below a set hurdle rate, the instrument is considered to be level 3. This hurdle rate is consistent with the rate used in the IPV process to determine whether or not the data is of sufficient quality to adjust the instrument's valuations. However, where an instrument is generally considered to be illiquid, but regular quotes from market participants exist, these instruments may be classified as level 2 depending on frequency of quotes, other available pricing and whether the quotes are used as part of the IPV process or not.

For some instruments with a wide number of available price sources, there may be differing quality of available information and there may be a wide range of prices from different sources. In these situations an assessment is made as to which source is the highest quality and this will be used to determine the classification of the asset. For example, a tradable quote would be considered a better source than a consensus price.

#### Instruments that cross levels

Some instruments will predominantly be in one level or the other, but others may cross between levels. For example, a cross currency swap may be between very liquid currency pairs where pricing is readily observed in the market and will therefore be classified as level 2. The cross currency swap may also be between two illiquid currency pairs in which case the swap would be placed into level 3. Defining the difference between liquid and illiquid may be based upon the number of consensus providers the consensus price is made up from and whether the consensus price can be supplemented by other sources.

#### Level 3 portfolios and sensitivity methodologies

For each of the portfolio categories shown in the tables above, there follows a description of the types of products that comprise the portfolio and the valuation techniques that are applied in determining fair value, including a description of valuation techniques used for levels 2 and 3 and inputs to those models and techniques. Where reasonably possible alternative assumptions of unobservable inputs used in models would change the fair value of the portfolio significantly, the alternative inputs are indicated. Where there have been significant changes to valuation techniques during the year a discussion of the reasons for this are also included.

#### Overview of sensitivity methodologies

Reasonably possible alternative assumptions of unobservable inputs are determined based on a 95% confidence interval. The assessments recognise different favourable and unfavourable valuation movements where appropriate. Each unobservable input within a product is considered separately and sensitivity is reported on an additive basis.



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## Notes on the accounts

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### 11 Financial instruments - valuation continued

Alternative assumptions are determined with reference to all available evidence including consideration of the following: quality of independent pricing information taking into account consistency between different sources, variation over time, perceived tradability or otherwise of available quotes; consensus service dispersion ranges; volume of trading activity and market bias (e.g. one-way inventory); day 1 P&L arising on new trades; number and nature of market participants; market conditions; modelling consistency in the market; size and nature of risk; length of holding of position; and market intelligence.

#### Loans and advances to customers

Loans in level 3 primarily comprise loans to emerging market counterparties, structured loans and legacy commercial mortgages.

#### Loans to emerging market counterparties

The trades in each loan structure are valued using curves using a proxy methodology. Each curve consists of the independent proxy value and various basis adjustments, such as those relating to loan-CDS basis, credit basis, tenor and liquidity. For the low and high valuation scenarios for the structures, these different bases are flexed up and down within the range that each one is deemed to span. The resultant maximum and minimum scenario curves are used to value the assets and liabilities in the structure separately. The low valuation scenario is the one that minimises the assets and maximises the liabilities. The high valuation scenario is the converse.

#### Commercial mortgages

These senior and mezzanine commercial mortgages are loans secured on commercial land and buildings that were originated or acquired by the Group for securitisation. Senior commercial mortgages carry a variable interest rate and mezzanine or more junior commercial mortgages may carry a fixed or variable interest rate. Factors affecting the value of these loans may include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratios, prepayment rates, cumulative loan loss information, yields, investor demand, market volatility since the last securitisation and credit enhancement. Where observable market prices for a particular loan are not available, the fair value will typically be determined with reference to observable market transactions in other loans or credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the loan and the available benchmark data.

#### Residential mortgages

These pools of residential mortgages were mostly acquired for securitisation before the 2008 financial crisis. Factors that affect the value, or liquidation level, of these loans are geographic location, current loan-to-value, condition of the home, and availability of eligible buyers. The loans are serviced by various mortgage servicers. Operations and the Front Office monitor the performance of these loans and the valuations are tested against an estimated recovery level as part of the IPV process. The market for non-agency securitisation remains extremely weak and is restricted to new issue prime loans.

#### Debt securities

Level 3 debt securities principally comprise asset-backed securities.

#### Residential mortgage-backed securities (RMBS)

RMBS where the underlying assets are US agency-backed mortgages and there is regular trading are generally classified as level 2 in the fair value hierarchy. RMBS are also classified as level 2 when regular trading is not prevalent in the market, but similar executed trades or third-party data including indices, broker quotes and pricing services can be used to substantiate the fair value. RMBS are classified as level 3 when trading activity is not available and a model with significant unobservable data is utilised.

In determining whether an instrument is similar to that being valued, the Group considers a range of factors, principally: the lending standards of the brokers and underwriters that originated the mortgages, the lead manager of the security, the issue date of the respective securities, the underlying asset composition (including origination date, loan to value ratios, historic loss information and geographic location of the mortgages), the credit rating of the instrument, and any credit protection that the instrument may benefit from, such as insurance wraps or subordinated tranches. Where there are instances of market observable data for several similar RMBS tranches, the Group considers the extent of similar characteristics shared with the instrument being valued, together with the frequency, tenor and nature of the trades that have been observed. This method is most frequently used for US and UK RMBS. RMBS of Dutch and Spanish originated mortgages guaranteed by those governments are valued using the credit spreads of the respective government debt and certain assumptions made by the Group, or based on observable prices from Bloomberg or consensus pricing services.

The Group primarily uses an industry standard model to project the expected future cash flows to be received from the underlying mortgages and to forecast how these cash flows will be distributed to the various holders of the RMBS. This model utilises data provided by the servicer of the underlying mortgage portfolio, layering on assumptions for mortgage prepayments, probability of default, expected losses, and yield. The Group uses data from third-party sources to calibrate its assumptions, including pricing information from third party pricing services, independent research, broker quotes, and other independent sources. An assessment is made of third-party data source to determine its applicability and reliability. The Group adjusts the model price with a liquidity premium to reflect the price that the instrument could be traded in the market and may also make adjustments for model deficiencies.

The fair value of securities within each class of asset changes on a broadly consistent basis in response to changes in given market factors. However, the extent of the change, and therefore the range of reasonably possible alternative assumptions, may be either more or less pronounced, depending on the particular terms and circumstances of the individual security. The Group believes that probability of default was the least transparent input into Alt-A and prime RMBS modelled valuations (and most sensitive to variations).

#### Commercial mortgage-backed securities (CMBS)

CMBS are valued using an industry standard model and the inputs, where possible, are corroborated using observable market data.



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## Notes on the accounts

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### 11 Financial instruments - valuation continued

#### *Collateralised debt obligations (CDO)*

CDOs purchased from third parties are valued using independent, third-party quotes or independent lead manager indicative prices. For super senior CDOs which have been originated by the Group no specific third-party information is available. The valuation of these super senior CDOs therefore takes into consideration outputs from a proprietary model, market data and appropriate valuation adjustments.

A collateral net asset value methodology using dealer buy side marks is used to determine an upper bound for super senior CDO valuations. An ABS index implied collateral valuation, is also used to provide a market calibrated valuation data point. Both the ABS index implied valuation and the collateral net asset value methodology apply an assumed immediate liquidation approach.

#### *Collateralised loan obligations (CLO)*

To determine the fair value of CLOs purchased from third parties, the Group uses third party broker or lead manager quotes as the primary pricing source. These quotes are benchmarked to consensus pricing sources where they are available.

For CLOs originated and still held by the Group, the fair value is determined using a correlation model based on a Monte Carlo simulation framework. The main model inputs are credit spreads and recovery rates of the underlying assets and their correlation. A credit curve is assigned to each underlying asset based on prices from third party dealer quotes and cash flow profiles, sourced from an industry standard model. Losses are calculated taking into account the attachment and detachment point of the exposure. Where the correlation inputs to this model are not observable, CLOs are classified as level 3.

#### *Other asset-backed and corporate debt securities*

Where observable market prices for a particular debt security are not available, the fair value will typically be determined with reference to observable market transactions in other related products, such as similar debt securities or credit derivatives. Assumptions are made about the relationship between the individual debt security and the available benchmark data. Where significant management judgement has been applied in identifying the most relevant related product, or in determining the relationship between the related product and the instrument itself, the instrument is classified as level 3.

#### *Equity shares*

Private equity investments include unit holdings and limited partnership interests primarily in corporate private equity funds, debt funds and fund of hedge funds. Externally managed funds are valued using recent prices where available. Where not available, the fair value of investments in externally managed funds is generally determined using statements or other information provided by the fund managers.

The Group considers that valuations may rely significantly on the judgements and estimates made by the fund managers, particularly in assessing private equity components. Given the decline in liquidity in world markets, and the level of subjectivity, these are included in level 3.

#### *Derivatives*

Derivatives are priced using quoted prices for the same or similar instruments where these are available. However, the majority of derivatives are valued using pricing models. Inputs for these models are usually observed directly in the market, or derived from observed prices. However, it is not always possible to observe or corroborate all model inputs. Unobservable inputs used are based on estimates taking into account a range of available information including historic analysis, historic traded levels, market practice, comparison to other relevant benchmark observable data and consensus pricing data.

#### *Credit derivatives*

The Group's other credit derivatives include vanilla and bespoke portfolio tranches, gap risk products and certain other unique trades.

Valuation of single name credit derivatives is carried out using industry standard models. Where single name derivatives have been traded and there is a lack of independent data or the quality of the data is weak, these instruments are classified into level 3. These assets will be priced using the Group's standard credit derivative model using a proxy curve based upon a suitable alternative single name curve, a cash based product or a sector based curve. Where the sector based curve is used, the proxy will be chosen taking maturity, rating, seniority, geography and internal credit review on recoveries into account. Sensitivities for these instruments will be based upon the selection of reasonable alternative assumptions which may include adjustments to the credit curve and recovery rate assumptions.

The bespoke portfolio tranches are synthetic tranches referenced to a bespoke portfolio of corporate names on which the Group purchases credit protection. Bespoke portfolio tranches are valued using Gaussian Copula, a standard method which uses observable market inputs (credit spreads, index tranche prices and recovery rates) to generate an output price for the tranche by way of a mapping methodology. In essence this method takes the expected loss of the tranche expressed as a fraction of the expected loss of the whole underlying portfolio and calculates which detachment point on the liquid index, and hence which correlation level, coincides with this expected loss fraction. Where the inputs into this valuation technique are observable in the market, bespoke tranches are considered to be level 2 assets. Where inputs are not observable, bespoke tranches are considered to be level 3 assets. However, all transactions executed with a CDPC counterparty are considered level 3 as the valuation adjustment applied to these exposures is a significant component of these valuations.

Gap risk products are leveraged trades, with the counterparty's potential loss capped at the amount of the initial principal invested. Gap risk is the probability that the market will move discontinuously too quickly to exit a portfolio and return the principal to the counterparty without incurring losses, should an unwind event be triggered. This optionality is embedded within these portfolio structures and is very rarely traded outright in the market. Gap risk is not observable in the markets and, as such, these structures are deemed to be level 3 instruments.

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## Notes on the accounts

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### 11 Financial instruments - valuation continued

Other unique trades are valued using a specialised model for each instrument and the same market data inputs as all other trades where applicable. By their nature, the valuation is also driven by a variety of other model inputs, many of which are unobservable in the market. Where these instruments have embedded optionality they are valued using a variation of the Black-Scholes option pricing formula, and where they have correlation exposure they are valued using a variant of the Gaussian Copula model. The volatility or unique correlation inputs required to value these products are generally unobservable and the instruments are therefore deemed to be level 3 instruments.

#### *Equity derivatives*

Equity derivative products are split into equity exotic derivatives and equity hybrids. Equity exotic derivatives have payouts based on the performance of one or more stocks, equity funds or indices. Most payouts are based on the performance of a single asset and are valued using observable market option data. Unobservable equity derivative trades are typically complex basket options on stocks. Such basket option payouts depend on the performance of more than one equity asset and require correlations for their valuation. Valuation is then performed using industry standard valuation models, with unobservable correlation inputs calculated by reference to correlations observed between similar underlyings.

Equity hybrids have payouts based on the performance of a basket of underlyings where underlyings are from different asset classes. Correlations between these different underlyings are typically unobservable with no market information on closely related assets available. Where no market for the correlation input exists, these inputs are based on historical time series.

#### *Interest rate and commodity derivatives*

Interest rate and commodity options provide a payout (or series of payouts) linked to the performance of one or more underlying, including interest rates, foreign exchange rates and commodities.

Exotic options do not trade in active markets except in a small number of cases. Consequently, the Group uses models to determine fair value using valuation techniques typical for the industry. These techniques can be divided firstly, into modelling approaches and secondly, into methods of assessing appropriate levels for model inputs. The Group uses a variety of proprietary models for valuing exotic trades.

Exotic valuation inputs include the correlation between interest rates, foreign exchange rates and commodity prices. Correlations for more liquid rate pairs are valued using independently sourced consensus pricing levels. Where a consensus pricing benchmark is unavailable, these instruments are classified as level 3.

The carrying value of debt securities in issue is represented partly by underlying cash and partly through a derivative component. The classification of the amount in level 3 is driven by the derivative component and not by the cash element.

#### *Other financial instruments*

In addition to the portfolios discussed above, there are other financial instruments which are held at fair value determined from data which are not market observable, or incorporating material adjustments to market observed data.

### Other considerations

#### *Valuation adjustments*

CVA applied to derivative exposures to other counterparties and own credit adjustments applied to derivative liabilities (DVA) are calculated on a portfolio basis. Whilst the methodology used to calculate each of these adjustments references certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the net valuation of the related portfolios. The classification of the derivative portfolios which the valuation adjustments are applied to is not determined by the observability of the valuation adjustments, and any related sensitivity does not form part of the level 3 sensitivities presented.

#### *Funding related adjustments*

The discount rates applied to derivative cash-flows in determining fair value reflect any underlying collateral agreements. Collateralised derivative exposures are generally discounted at the relevant OIS rates whilst funding valuation adjustments are applied to uncollateralised derivative exposures. Whilst these adjustments reference certain inputs which are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of the individual trades. The classification of derivatives is not determined by the observability of these adjustments, and any related sensitivity does not form part of the level 3 sensitivities presented.

#### *Own credit - issued debt*

For notes issued the own credit adjustment is based on debt issuance spreads above average inter-bank rates at the reporting date (at a range of tenors). Whilst certain debt issuance spreads are not based on observable market data, these inputs are not considered to have a significant effect on the valuation of individual trades. Neither the classification of structured notes issued nor any related valuation sensitivities are determined by the observability of the debt issuance spreads.

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Level 3 movement table

| 2013                     | Amounts recorded in the |               |          | Level 3 transfers |       |           |           |             |         |                  | Amounts recorded in the income statement on |            | balances at year end |    |
|--------------------------|-------------------------|---------------|----------|-------------------|-------|-----------|-----------|-------------|---------|------------------|---------------------------------------------|------------|----------------------|----|
|                          | At                      | Income        | SOCI (2) | In                | Out   | Purchases | Issuances | Settlements | Sales   | Foreign exchange | At                                          | Unrealised | Realised             |    |
|                          | 1 January               | statement (1) | £m       |                   |       |           |           |             |         |                  | £m                                          |            |                      | £m |
|                          | £m                      | £m            | £m       | £m                | £m    | £m        | £m        | £m          | £m      | £m               | £m                                          | £m         | £m                   |    |
| Assets                   |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| FVTPL (3)                |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| Loans and advances       |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| - banks                  | 383                     | (48)          | —        | —                 | —     | —         | —         | (19)        | —       | (6)              | 310                                         | (93)       | 45                   |    |
| - customers              | 559                     | (32)          | —        | 87                | (6)   | 68        | —         | (66)        | (446)   | 8                | 172                                         | (90)       | 12                   |    |
| Debt securities          | 1,931                   | 77            | —        | 198               | (64)  | 521       | —         | (121)       | (1,609) | (28)             | 905                                         | (42)       | 87                   |    |
| Equity shares            | 327                     | (3)           | —        | 25                | (62)  | 35        | —         | (20)        | (72)    | —                | 230                                         | 3          | 3                    |    |
| Derivatives              | 3,901                   | (490)         | —        | 897               | (224) | 382       | —         | (600)       | (299)   | (1)              | 3,566                                       | (574)      | 10                   |    |
| FVTPL assets             | 7,101                   | (496)         | —        | 1,207             | (356) | 1,006     | —         | (826)       | (2,426) | (27)             | 5,183                                       | (796)      | 157                  |    |
| AFS                      |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| Debt securities          | 2,933                   | 66            | 150      | 129               | (13)  | 69        | —         | (721)       | (1,420) | (20)             | 1,173                                       | 15         | 41                   |    |
| Equity shares            | 170                     | 16            | 13       | 44                | (1)   | 26        | —         | (4)         | (38)    | (19)             | 207                                         | 1          | —                    |    |
| AFS assets               | 3,103                   | 82            | 163      | 173               | (14)  | 95        | —         | (725)       | (1,458) | (39)             | 1,380                                       | 16         | 41                   |    |
|                          | 10,204                  | (414)         | 163      | 1,380             | (370) | 1,101     | —         | (1,551)     | (3,884) | (66)             | 6,563                                       | (780)      | 198                  |    |
| Of which ABS             |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| - FVTPL (3)              | 1,351                   | 85            | —        | 197               | (60)  | 489       | —         | (121)       | (1,348) | (2)              | 591                                         | (17)       | 76                   |    |
| - AFS                    | 2,837                   | 61            | 152      | 129               | (13)  | 68        | —         | (719)       | (1,420) | 13               | 1,108                                       | 13         | 41                   |    |
| Liabilities              |                         |               |          |                   |       |           |           |             |         |                  |                                             |            |                      |    |
| Deposits                 | 32                      | 2             | —        | 8                 | (31)  | 195       | 11        | (2)         | —       | (2)              | 213                                         | 2          | —                    |    |
| Debt securities in issue | 1,332                   | 64            | —        | 204               | (189) | —         | 425       | (537)       | —       | (7)              | 1,292                                       | 1          | 50                   |    |
| Short positions          | 1                       | —             | —        | 22                | —     | 5         | —         | —           | (10)    | —                | 18                                          | (2)        | 1                    |    |
| Derivatives              | 3,484                   | (17)          | —        | 464               | (231) | 336       | —         | (723)       | (260)   | (1)              | 3,052                                       | (106)      | 17                   |    |
|                          | 4,849                   | 49            | —        | 698               | (451) | 536       | 436       | (1,262)     | (270)   | (10)             | 4,575                                       | (105)      | 68                   |    |
| Net (losses)/gains       |                         | (463)         | 163      |                   |       |           |           |             |         |                  |                                             | (675)      | 130                  |    |

For the notes to this table refer to page 260.

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Level 3 movement table continued

| 2012                     | Amounts recorded in the |               |          | Level 3 transfers |         |           |           |             |         |                  | Amounts recorded in the income statement on |                      |     |
|--------------------------|-------------------------|---------------|----------|-------------------|---------|-----------|-----------|-------------|---------|------------------|---------------------------------------------|----------------------|-----|
|                          | At                      | Income        | SOCI (2) | In                | Out     | Purchases | Issuances | Settlements | Sales   | Foreign exchange | At                                          | balances at year end |     |
|                          | 1 January               | statement (1) | £m       |                   |         |           |           |             |         |                  | £m                                          | £m                   | £m  |
|                          | £m                      | £m            | £m       | £m                | £m      | £m        | £m        | £m          | £m      | £m               | £m                                          | £m                   | £m  |
| Assets                   |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| FVTPL (3)                |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| Loans and advances       |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| - banks                  | 443                     | 5             | —        | 28                | (1)     | —         | —         | (64)        | (30)    | 2                | 383                                         | 5                    | —   |
| - customers              | 316                     | 3             | —        | 20                | (16)    | 589       | —         | (324)       | (15)    | (14)             | 559                                         | (12)                 | 3   |
| Debt securities          | 1,911                   | 127           | —        | 617               | (81)    | 1,451     | —         | (188)       | (1,885) | (21)             | 1,931                                       | (54)                 | 72  |
| Equity shares            | 350                     | (17)          | —        | 32                | (4)     | 149       | —         | (73)        | (106)   | (4)              | 327                                         | (18)                 | 4   |
| Derivatives              | 6,850                   | (2,085)       | —        | 472               | (695)   | 621       | —         | (1,014)     | (191)   | (57)             | 3,901                                       | (1,744)              | 36  |
| FVTPL assets             | 9,870                   | (1,967)       | —        | 1,169             | (797)   | 2,810     | —         | (1,663)     | (2,227) | (94)             | 7,101                                       | (1,823)              | 115 |
| AFS                      |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| Debt securities          | 5,663                   | 77            | 10       | 391               | (472)   | 78        | —         | (1,000)     | (1,808) | (6)              | 2,933                                       | (145)                | 39  |
| Equity shares            | 210                     | 29            | 27       | 17                | —       | 14        | —         | (1)         | (118)   | (8)              | 170                                         | 1                    | 12  |
| AFS assets               | 5,873                   | 106           | 37       | 408               | (472)   | 92        | —         | (1,001)     | (1,926) | (14)             | 3,103                                       | (144)                | 51  |
|                          | 15,743                  | (1,861)       | 37       | 1,577             | (1,269) | 2,902     | —         | (2,664)     | (4,153) | (108)            | 10,204                                      | (1,967)              | 166 |
| Of which is ABS          |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| - FVTP (3)               | 1,304                   | 163           | —        | 576               | (32)    | 1,050     | —         | (188)       | (1,515) | (7)              | 1,351                                       | 15                   | 61  |
| - AFS                    | 5,601                   | 86            | (12)     | 317               | (457)   | 76        | —         | (992)       | (1,778) | (4)              | 2,837                                       | (97)                 | 34  |
| Liabilities              |                         |               |          |                   |         |           |           |             |         |                  |                                             |                      |     |
| Deposits                 | 22                      | 9             | —        | 1                 | —       | —         | —         | —           | —       | —                | 32                                          | 8                    | —   |
| Debt securities in issue | 1,793                   | 175           | —        | 9                 | —       | —         | 530       | (1,174)     | —       | (1)              | 1,332                                       | 184                  | —   |
| Short positions          | 235                     | (213)         | —        | —                 | —       | 3         | —         | —           | (23)    | (1)              | 1                                           | —                    | —   |
| Derivatives              | 3,991                   | (413)         | —        | 848               | (420)   | 369       | 12        | (894)       | 35      | (44)             | 3,484                                       | (619)                | 2   |
|                          | 6,041                   | (442)         | —        | 858               | (420)   | 372       | 542       | (2,068)     | 12      | (46)             | 4,849                                       | (427)                | 2   |
| Net (losses)/gains       |                         | (1,419)       | 37       |                   |         |           |           |             |         |                  |                                             | (1,540)              | 164 |

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

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Level 3 movement table continued

|                             | At<br>1 January | Amounts<br>recorded in the    |                | Level 3 transfers |           | Purchases | Issuances | Settlements | Sales   | Foreign<br>exchange | At<br>31 December | Amounts recorded in<br>the income statement<br>on balances at year end |
|-----------------------------|-----------------|-------------------------------|----------------|-------------------|-----------|-----------|-----------|-------------|---------|---------------------|-------------------|------------------------------------------------------------------------|
| 2011                        | £m              | Income<br>statement (1)<br>£m | SOCI (2)<br>£m | In<br>£m          | Out<br>£m | £m        | £m        | £m          | £m      | £m                  | £m                | £m                                                                     |
| <b>Assets</b>               |                 |                               |                |                   |           |           |           |             |         |                     |                   |                                                                        |
| <b>FVTPL (3)</b>            |                 |                               |                |                   |           |           |           |             |         |                     |                   |                                                                        |
| <b>Loans and advances</b>   |                 |                               |                |                   |           |           |           |             |         |                     |                   |                                                                        |
| - banks                     | 407             | 5                             | —              | 60                | —         | 49        | —         | (36)        | (40)    | (2)                 | 443               | 2                                                                      |
| - customers                 | 251             | (3)                           | —              | 85                | —         | 649       | —         | (622)       | (45)    | 1                   | 316               | (13)                                                                   |
| Debt securities             | 2,920           | (17)                          | —              | 114               | (254)     | 1,066     | —         | (149)       | (1,761) | (8)                 | 1,911             | (91)                                                                   |
| Equity shares               | 410             | (18)                          | —              | 32                | (16)      | 49        | —         | (22)        | (80)    | (5)                 | 350               | (20)                                                                   |
| Derivatives                 | 5,484           | (479)                         | —              | 3,142             | (1,360)   | 776       | —         | (653)       | (120)   | 60                  | 6,850             | (592)                                                                  |
| FVTPL assets                | 9,472           | (512)                         | —              | 3,433             | (1,630)   | 2,589     | —         | (1,482)     | (2,046) | 46                  | 9,870             | (714)                                                                  |
| <b>AFS</b>                  |                 |                               |                |                   |           |           |           |             |         |                     |                   |                                                                        |
| Debt securities             | 4,335           | 2                             | 3              | 2,097             | (21)      | 98        | —         | (806)       | (47)    | 2                   | 5,663             | 2                                                                      |
| Equity shares               | 188             | (5)                           | 33             | 6                 | —         | 6         | —         | (1)         | (17)    | —                   | 210               | (4)                                                                    |
| AFS assets                  | 4,523           | (3)                           | 36             | 2,103             | (21)      | 104       | —         | (807)       | (64)    | 2                   | 5,873             | (2)                                                                    |
|                             | 13,995          | (515)                         | 36             | 5,536             | (1,651)   | 2,693     | —         | (2,289)     | (2,110) | 48                  | 15,743            | (716)                                                                  |
| <b>Liabilities</b>          |                 |                               |                |                   |           |           |           |             |         |                     |                   |                                                                        |
| Deposits                    | 262             | (40)                          | —              | —                 | —         | —         | —         | (4)         | (195)   | (1)                 | 22                | (25)                                                                   |
| Debt securities in issue    | 231             | (41)                          | —              | 857               | (436)     | 908       | 275       | (2)         | —       | 1                   | 1,793             | (41)                                                                   |
| Short positions             | 772             | (71)                          | —              | —                 | (1)       | 14        | 20        | —           | (502)   | 3                   | 235               | (207)                                                                  |
| Derivatives                 | 1,359           | 291                           | —              | 1,860             | (173)     | 873       | 8         | (165)       | (97)    | 35                  | 3,991             | 275                                                                    |
| Other financial liabilities | 1               | —                             | —              | —                 | (1)       | —         | —         | —           | —       | —                   | —                 | —                                                                      |
|                             | 2,625           | 139                           | —              | 2,717             | (611)     | 1,795     | 303       | (171)       | (794)   | 38                  | 6,041             | 2                                                                      |
| <b>Net (losses)/gains</b>   |                 | (654)                         | 36             |                   |           |           |           |             |         |                     |                   | (718)                                                                  |

#### Notes:

- (1) Net losses on HFT instruments of £453 million (2012 - £1,481 million; 2011 - £650 million) and net losses on other instruments of £10 million (2012 - £62 million gains; 2011 - £4 million losses) were recorded in other operating income, interest income and impairment losses as appropriate.
- (2) Consolidated statement of comprehensive income.
- (3) Fair value through profit or loss comprises held-for-trading predominantly and designated at fair value through profit of loss.

## Notes on the accounts

### 11 Financial instruments - valuation continued

#### Fair value of financial instruments not carried at fair value

The following table shows the carrying value and fair value of financial instruments carried at amortised cost on the balance sheet.

| 2013                                  | Group                                  |                |            |                            |             | Bank                                   |                |            |                            |             |
|---------------------------------------|----------------------------------------|----------------|------------|----------------------------|-------------|----------------------------------------|----------------|------------|----------------------------|-------------|
|                                       | Fair value approximates carrying value | Carrying value | Fair value | Fair value hierarchy level |             | Fair value approximates carrying value | Carrying value | Fair value | Fair value hierarchy level |             |
|                                       | £bn                                    | £bn            | £bn        | Level 2 £bn                | Level 3 £bn | £bn                                    | £bn            | £bn        | Level 2 £bn                | Level 3 £bn |
| Financial assets                      |                                        |                |            |                            |             |                                        |                |            |                            |             |
| Cash and balances at central banks    | 80.0                                   |                |            |                            |             | 75.8                                   |                |            |                            |             |
| Loans and advances to banks           |                                        |                |            |                            |             |                                        |                |            |                            |             |
| - items in the course of collection   |                                        |                |            |                            |             |                                        |                |            |                            |             |
| from other banks                      | 1.5                                    |                |            |                            |             | 0.3                                    |                |            |                            |             |
| - other                               |                                        | 26.2           | 26.2       | 7.4                        | 18.8        |                                        | 41.4           | 41.7       | 23.3                       | 18.4        |
| Loans and advances to customers       |                                        | 370.3          | 358.9      | 14.8                       | 344.1       |                                        | 161.6          | 158.6      | 23.3                       | 135.3       |
| Debt securities                       |                                        | 3.7            | 3.1        | 1.9                        | 1.2         |                                        | 29.2           | 28.4       | 25.4                       | 3.0         |
| Settlement balances                   | 5.6                                    |                |            |                            |             | 3.5                                    |                |            |                            |             |
| Financial liabilities                 |                                        |                |            |                            |             |                                        |                |            |                            |             |
| Deposits by banks                     |                                        |                |            |                            |             |                                        |                |            |                            |             |
| - items in the course of transmission |                                        |                |            |                            |             |                                        |                |            |                            |             |
| to other banks                        | 0.8                                    |                |            |                            |             | 0.3                                    |                |            |                            |             |
| - other                               |                                        | 21.9           | 21.9       | 7.2                        | 14.7        |                                        | 141.0          | 141.0      | 41.5                       | 99.5        |
| Customer accounts                     |                                        |                |            |                            |             |                                        |                |            |                            |             |
| - demand deposits                     | 266.9                                  |                |            |                            |             | 77.0                                   |                |            |                            |             |
| - other                               |                                        | 137.6          | 137.7      | 88.9                       | 48.8        |                                        | 69.6           | 69.2       | 24.8                       | 44.4        |
| Debt securities in issue              |                                        | 36.2           | 37.4       | 33.3                       | 4.1         |                                        | 28.9           | 30.5       | 27.9                       | 2.6         |
| Settlement balances                   | 5.2                                    |                |            |                            |             | 2.3                                    |                |            |                            |             |
| Notes in circulation                  | 1.8                                    |                |            |                            |             | 1.1                                    |                |            |                            |             |
| Subordinated liabilities              |                                        | 32.8           | 33.2       | 33.1                       | 0.1         |                                        | 30.2           | 30.8       | 30.8                       | —           |

|                                    | Group                            |                              |                                  |                              | Bank                             |                              |                                  |                              |
|------------------------------------|----------------------------------|------------------------------|----------------------------------|------------------------------|----------------------------------|------------------------------|----------------------------------|------------------------------|
|                                    | 2012<br>Carrying<br>value<br>£bn | 2012<br>Fair<br>value<br>£bn | 2011<br>Carrying<br>value<br>£bn | 2011<br>Fair<br>value<br>£bn | 2012<br>Carrying<br>value<br>£bn | 2012<br>Fair<br>value<br>£bn | 2011<br>Carrying<br>value<br>£bn | 2011<br>Fair<br>value<br>£bn |
|                                    |                                  |                              |                                  |                              |                                  |                              |                                  |                              |
| <b>Financial assets</b>            |                                  |                              |                                  |                              |                                  |                              |                                  |                              |
| Cash and balances at central banks | 74.5                             | 74.5                         | 68.5                             | 68.5                         | 70.4                             | 70.4                         | 64.3                             | 64.3                         |
| Loans and advances to banks        | 32.3                             | 32.2                         | 29.9                             | 29.8                         | 64.9                             | 65.5                         | 50.0                             | 50.2                         |
| Loans and advances to customers    | 400.1                            | 380.9                        | 410.7                            | 381.8                        | 185.6                            | 178.7                        | 273.0                            | 258.1                        |
| Debt securities                    | 4.3                              | 3.9                          | 5.5                              | 4.9                          | 35.2                             | 35.3                         | 71.2                             | 70.8                         |
| Settlement balances                | 5.7                              | 5.7                          | 6.9                              | 6.9                          | 3.1                              | 3.1                          | 4.1                              | 4.1                          |
| <b>Financial liabilities</b>       |                                  |                              |                                  |                              |                                  |                              |                                  |                              |
| Deposits by banks                  | 34.2                             | 34.2                         | 46.7                             | 46.1                         | 146.0                            | 146.1                        | 170.2                            | 170.1                        |
| Customer accounts                  | 419.2                            | 419.6                        | 387.6                            | 387.7                        | 187.1                            | 183.8                        | 226.5                            | 223.5                        |
| Debt securities in issue           | 50.3                             | 50.1                         | 102.6                            | 100.5                        | 39.5                             | 40.3                         | 76.3                             | 75.7                         |
| Settlement balances                | 5.8                              | 5.8                          | 6.8                              | 6.8                          | 2.9                              | 2.9                          | 3.5                              | 3.5                          |
| Notes in circulation               | 1.7                              | 1.7                          | 1.7                              | 1.7                          | 1.1                              | 1.1                          | 1.1                              | 1.1                          |
| Subordinated liabilities           | 33.3                             | 33.8                         | 31.9                             | 28.7                         | 31.1                             | 31.9                         | 29.5                             | 27.0                         |

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## Notes on the accounts

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### 11 Financial instruments - valuation continued

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Quoted market values are used where available; otherwise, fair values have been estimated based on discounted expected future cash flows and other valuation techniques. These techniques involve uncertainties and require assumptions and judgments covering prepayments, credit risk and discount rates. Furthermore there is a wide range of potential valuation techniques. Changes in these assumptions would significantly affect estimated fair values. The fair values reported would not necessarily be realised in an immediate sale or settlement.

The fair values of intangible assets, such as core deposits, credit card and other customer relationships are not included in the calculation of these fair values as they are not financial instruments.

The assumptions and methodologies underlying the calculation of fair values of financial instruments at the balance sheet date are as follows:

For certain short-term financial instruments: cash and balances at central banks, items in the course of collection from other banks, settlement balances, items in the course of transmission to other banks, customer demand deposits and notes in circulation, fair value approximates to carrying value.

### Loans and advances to banks and customers

In estimating the fair value of loans and advances to banks and customers measured at amortised cost, the Group's loans are segregated into appropriate portfolios reflecting the characteristics of the constituent loans. Two principal methods are used to estimate fair value:

- (a) Contractual cash flows are discounted using a market discount rate that incorporates the current spread for the borrower or where this is not observable, the spread for borrowers of a similar credit standing. This method is used for portfolios where counterparties have external ratings: large corporate loans in UK Corporate and institutional and corporate lending in International Banking and Markets.
- (b) Expected cash flows (unadjusted for credit losses) are discounted at the current offer rate for the same or similar products. This approach is adopted for lending portfolios in UK Retail, Ulster Bank, US Retail & Commercial and Wealth and SME loans in UK Corporate reflecting the homogeneous nature of these portfolios.

For certain portfolios where there are very few or no recent transactions, such as Ulster Bank's portfolio of lifetime tracker mortgages, a bespoke approach is used based on available market data.

### Debt securities

Fair values are determined using discounted cash flow valuation techniques.

### Deposits by banks and customer accounts

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

### Debt securities in issue and subordinated liabilities

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

## Notes on the accounts

### 12 Financial instruments - maturity analysis

#### Remaining maturity

The following table shows the residual maturity of financial instruments, based on contractual date of maturity.

|                                         | Group                        |                              |             |                              |                              |             |                              |                              |             |
|-----------------------------------------|------------------------------|------------------------------|-------------|------------------------------|------------------------------|-------------|------------------------------|------------------------------|-------------|
|                                         | 2013                         |                              |             | 2012                         |                              |             | 2011                         |                              |             |
|                                         | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m |
| <b>Assets</b>                           |                              |                              |             |                              |                              |             |                              |                              |             |
| Cash and balances at central banks      | 79,993                       | —                            | 79,993      | 74,524                       | —                            | 74,524      | 68,487                       | —                            | 68,487      |
| Loans and advances to banks             | 65,111                       | 1,372                        | 66,483      | 80,625                       | 1,442                        | 82,067      | 93,304                       | 3,836                        | 97,140      |
| Loans and advances to customers         | 167,988                      | 271,112                      | 439,100     | 194,968                      | 299,869                      | 494,837     | 181,880                      | 307,519                      | 489,399     |
| Debt securities                         | 18,233                       | 82,463                       | 100,696     | 24,088                       | 112,497                      | 136,585     | 37,178                       | 131,963                      | 169,141     |
| Equity shares                           | —                            | 8,278                        | 8,278       | —                            | 13,872                       | 13,872      | —                            | 11,762                       | 11,762      |
| Settlement balances                     | 5,634                        | —                            | 5,634       | 5,717                        | —                            | 5,717       | 6,902                        | —                            | 6,902       |
| Derivatives                             | 45,001                       | 244,402                      | 289,403     | 51,248                       | 393,853                      | 445,101     | 60,216                       | 472,591                      | 532,807     |
| <b>Liabilities</b>                      |                              |                              |             |                              |                              |             |                              |                              |             |
| Deposits by banks                       | 62,007                       | 3,156                        | 65,163      | 93,742                       | 8,518                        | 102,260     | 95,725                       | 13,372                       | 109,097     |
| Customer accounts                       | 457,823                      | 14,481                       | 472,304     | 493,432                      | 25,765                       | 519,197     | 458,230                      | 14,158                       | 472,388     |
| Debt securities in issue                | 14,762                       | 44,984                       | 59,746      | 14,547                       | 68,731                       | 83,278      | 60,642                       | 80,195                       | 140,837     |
| Settlement balances and short positions | 10,417                       | 22,832                       | 33,249      | 8,499                        | 24,874                       | 33,373      | 14,037                       | 33,187                       | 47,224      |
| Derivatives                             | 45,434                       | 240,699                      | 286,133     | 51,958                       | 384,127                      | 436,085     | 62,487                       | 465,349                      | 527,836     |
| Subordinated liabilities                | 1,378                        | 31,756                       | 33,134      | 2,385                        | 31,466                       | 33,851      | 684                          | 31,640                       | 32,324      |

|                                         | Bank                         |                              |             |                              |                              |             |                              |                              |             |
|-----------------------------------------|------------------------------|------------------------------|-------------|------------------------------|------------------------------|-------------|------------------------------|------------------------------|-------------|
|                                         | 2013                         |                              |             | 2012                         |                              |             | 2011                         |                              |             |
|                                         | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m | Less than<br>12 months<br>£m | More than<br>12 months<br>£m | Total<br>£m |
| <b>Assets</b>                           |                              |                              |             |                              |                              |             |                              |                              |             |
| Cash and balances at central banks      | 75,792                       | —                            | 75,792      | 70,374                       | —                            | 70,374      | 64,261                       | —                            | 64,261      |
| Loans and advances to banks             | 67,248                       | 10,520                       | 77,768      | 89,433                       | 20,138                       | 109,571     | 96,531                       | 12,509                       | 109,040     |
| Loans and advances to customers         | 115,478                      | 109,896                      | 225,374     | 142,109                      | 129,440                      | 271,549     | 182,666                      | 168,457                      | 351,123     |
| Debt securities                         | 23,848                       | 68,479                       | 92,327      | 38,277                       | 84,170                       | 122,447     | 53,676                       | 127,784                      | 181,460     |
| Equity shares                           | —                            | 7,301                        | 7,301       | —                            | 12,766                       | 12,766      | —                            | 10,486                       | 10,486      |
| Settlement balances                     | 3,492                        | —                            | 3,492       | 3,090                        | —                            | 3,090       | 4,059                        | —                            | 4,059       |
| Derivatives                             | 45,156                       | 247,724                      | 292,880     | 51,288                       | 398,550                      | 449,838     | 60,230                       | 477,067                      | 537,297     |
| <b>Liabilities</b>                      |                              |                              |             |                              |                              |             |                              |                              |             |
| Deposits by banks                       | 151,007                      | 29,286                       | 180,293     | 179,390                      | 30,193                       | 209,583     | 210,057                      | 24,240                       | 234,297     |
| Customer accounts                       | 164,002                      | 29,551                       | 193,553     | 214,970                      | 41,364                       | 256,334     | 189,210                      | 107,692                      | 296,902     |
| Debt securities in issue                | 13,381                       | 38,157                       | 51,538      | 13,285                       | 58,209                       | 71,494      | 48,718                       | 65,806                       | 114,524     |
| Settlement balances and short positions | 6,409                        | 13,763                       | 20,172      | 4,606                        | 12,346                       | 16,952      | 9,957                        | 18,418                       | 28,375      |
| Derivatives                             | 45,584                       | 242,923                      | 288,507     | 52,048                       | 387,104                      | 439,152     | 62,467                       | 468,388                      | 530,855     |
| Subordinated liabilities                | 1,346                        | 29,220                       | 30,566      | 2,353                        | 29,282                       | 31,635      | 372                          | 29,642                       | 30,014      |



## Notes on the accounts

### 12 Financial instruments - maturity analysis continued

#### On balance sheet liabilities

The following tables show, by contractual maturity, the undiscounted cash flows payable up to a period of 20 years from the balance sheet date, including future payments of interest.

| 2013                                      | Group            |                   |                 |                 |                  |                   |
|-------------------------------------------|------------------|-------------------|-----------------|-----------------|------------------|-------------------|
|                                           | 0-3 months<br>£m | 3-12 months<br>£m | 1-3 years<br>£m | 3-5 years<br>£m | 5-10 years<br>£m | 10-20 years<br>£m |
| Deposits by banks                         | 18,647           | 1,498             | 1,296           | 149             | 803              | 426               |
| Customers accounts                        | 390,370          | 9,799             | 5,578           | 2,356           | 654              | 27                |
| Debt securities in issue                  | 10,642           | 6,466             | 11,977          | 6,087           | 8,709            | 4,414             |
| Derivatives held for hedging              | 54               | 99                | 541             | 980             | 1,532            | 240               |
| Subordinated liabilities                  | 488              | 2,244             | 6,356           | 6,189           | 18,029           | 6,240             |
| Settlement balances and other liabilities | 7,005            | 4                 | 9               | 4               | —                | 1                 |
|                                           | 427,206          | 20,110            | 25,757          | 15,765          | 29,727           | 11,348            |

#### Guarantees and commitments - notional amount

|                   |         |   |   |   |   |   |
|-------------------|---------|---|---|---|---|---|
| Guarantees (1, 2) | 15,912  | — | — | — | — | — |
| Commitments (3)   | 212,353 | — | — | — | — | — |
|                   | 228,265 | — | — | — | — | — |

#### 2012

|                                           |         |        |        |        |        |        |
|-------------------------------------------|---------|--------|--------|--------|--------|--------|
| Deposits by banks                         | 26,107  | 1,075  | 5,489  | 383    | 1,022  | 395    |
| Customers accounts                        | 382,714 | 26,838 | 11,494 | 2,148  | 1,208  | 64     |
| Debt securities in issue                  | 13,194  | 10,539 | 20,833 | 12,019 | 18,833 | 4,282  |
| Derivatives held for hedging              | 176     | 498    | 1,096  | 785    | 848    | 360    |
| Subordinated liabilities                  | 448     | 2,601  | 6,268  | 4,546  | 16,195 | 4,919  |
| Settlement balances and other liabilities | 7,500   | 4      | 8      | 1      | —      | 1      |
|                                           | 430,139 | 41,555 | 45,188 | 19,882 | 38,106 | 10,021 |

#### Guarantees and commitments - notional amount

|                   |         |   |   |   |   |   |
|-------------------|---------|---|---|---|---|---|
| Guarantees (1, 2) | 12,373  | — | — | — | — | — |
| Commitments (3)   | 212,149 | — | — | — | — | — |
|                   | 224,522 | — | — | — | — | — |

#### 2011

|                                           |         |        |        |        |        |        |
|-------------------------------------------|---------|--------|--------|--------|--------|--------|
| Deposits by banks                         | 35,596  | 4,487  | 5,256  | 400    | 1,008  | 364    |
| Customers accounts                        | 351,077 | 22,742 | 12,282 | 5,076  | 1,207  | 758    |
| Debt securities in issue                  | 63,623  | 11,342 | 17,869 | 14,241 | 15,640 | 3,380  |
| Derivatives held for hedging              | 216     | 524    | 1,174  | 739    | 739    | 583    |
| Subordinated liabilities                  | 13,819  | 2,341  | 5,315  | 5,085  | 7,700  | 9,700  |
| Settlement balances and other liabilities | 8,461   | 5      | 10     | 3      | 1      | 1      |
|                                           | 472,792 | 41,441 | 41,906 | 25,544 | 26,295 | 14,786 |

#### Guarantees and commitments - notional amount

|                   |         |   |   |   |   |   |
|-------------------|---------|---|---|---|---|---|
| Guarantees (1, 2) | 9,244   | — | — | — | — | — |
| Commitments (3)   | 221,145 | — | — | — | — | — |
|                   | 230,389 | — | — | — | — | — |

#### Notes:

- (1) The Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Group expects most guarantees it provides to expire unused.
- (2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £797 million (2012 - £2,901 million; 2011 - £5,753 million) between the Bank and a fellow subsidiary.
- (3) The Group has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Group does not expect all facilities to be drawn, and some may lapse before drawdown.

## Notes on the accounts

### 12 Financial instruments - maturity analysis continued

|                                              | Bank             |                   |                 |                 |                  |                   |
|----------------------------------------------|------------------|-------------------|-----------------|-----------------|------------------|-------------------|
|                                              | 0-3 months<br>£m | 3-12 months<br>£m | 1-3 years<br>£m | 3-5 years<br>£m | 5-10 years<br>£m | 10-20 years<br>£m |
| <b>2013</b>                                  |                  |                   |                 |                 |                  |                   |
| Deposits by banks                            | 106,951          | 7,727             | 8,897           | 5,105           | 2,375            | 14,900            |
| Customers accounts                           | 117,799          | 6,214             | 8,407           | 4,315           | 7,585            | 6,951             |
| Debt securities in issue                     | 4,349            | 6,339             | 11,687          | 5,774           | 8,243            | 3,892             |
| Derivatives held for hedging                 | 10               | 45                | 304             | 581             | 860              | 144               |
| Subordinated liabilities                     | 431              | 2,152             | 5,866           | 5,963           | 16,745           | 5,738             |
| Settlement balances and other liabilities    | 3,377            | —                 | —               | —               | —                | —                 |
|                                              | <b>232,917</b>   | <b>22,477</b>     | <b>35,161</b>   | <b>21,738</b>   | <b>35,808</b>    | <b>31,625</b>     |
| Guarantees and commitments - notional amount |                  |                   |                 |                 |                  |                   |
| Guarantees (1,2)                             | 12,045           | —                 | —               | —               | —                | —                 |
| Commitments (3)                              | 130,207          | —                 | —               | —               | —                | —                 |
|                                              | <b>142,252</b>   | <b>—</b>          | <b>—</b>        | <b>—</b>        | <b>—</b>         | <b>—</b>          |
| <b>2012</b>                                  |                  |                   |                 |                 |                  |                   |
| Deposits by banks                            | 122,785          | 7,501             | 11,689          | 4,307           | 542              | 146               |
| Customers accounts                           | 171,495          | 8,984             | 3,114           | 1,212           | 3,155            | 1,050             |
| Debt securities in issue                     | 5,038            | 10,496            | 20,827          | 12,018          | 18,831           | 4,276             |
| Derivatives held for hedging                 | 64               | 217               | 515             | 397             | 422              | 199               |
| Subordinated liabilities                     | 433              | 2,513             | 5,714           | 4,400           | 15,307           | 4,473             |
| Settlement balances and other liabilities    | 3,982            | —                 | —               | —               | —                | —                 |
|                                              | <b>303,797</b>   | <b>29,711</b>     | <b>41,859</b>   | <b>22,334</b>   | <b>38,257</b>    | <b>10,144</b>     |
| Guarantees and commitments - notional amount |                  |                   |                 |                 |                  |                   |
| Guarantees (1,2)                             | 8,436            | —                 | —               | —               | —                | —                 |
| Commitments (3)                              | 135,542          | —                 | —               | —               | —                | —                 |
|                                              | <b>143,978</b>   | <b>—</b>          | <b>—</b>        | <b>—</b>        | <b>—</b>         | <b>—</b>          |
| <b>2011</b>                                  |                  |                   |                 |                 |                  |                   |
| Deposits by banks                            | 147,543          | 6,828             | 9,692           | 3,992           | 926              | 85                |
| Customers accounts                           | 212,668          | 6,526             | 2,343           | 2,337           | 3,396            | 1,325             |
| Debt securities in issue                     | 40,982           | 11,296            | 17,577          | 14,183          | 15,618           | 3,232             |
| Derivatives held for hedging                 | 67               | 221               | 535             | 374             | 347              | 312               |
| Subordinated liabilities                     | 13,786           | 1,981             | 5,074           | 4,586           | 6,984            | 9,234             |
| Settlement balances and other liabilities    | 4,646            | —                 | —               | 1               | -                | -                 |
|                                              | <b>419,692</b>   | <b>26,852</b>     | <b>35,221</b>   | <b>25,473</b>   | <b>27,271</b>    | <b>14,188</b>     |
| Guarantees and commitments - notional amount |                  |                   |                 |                 |                  |                   |
| Guarantees (1,2)                             | 4,145            | —                 | —               | —               | —                | —                 |
| Commitments (3)                              | 145,472          | —                 | —               | —               | —                | —                 |
|                                              | <b>149,617</b>   | <b>—</b>          | <b>—</b>        | <b>—</b>        | <b>—</b>         | <b>—</b>          |

#### Notes:

- (1) The Bank is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. The Bank expects most guarantees it provides to expire unused.
- (2) Guarantees exclude the Asset Protection Scheme related financial guarantee contract of £797 million (2012 - £2,901 million; 2011 - £5,753 million) between the Bank and a fellow subsidiary.
- (3) The Bank has given commitments to provide funds to customers under undrawn formal facilities, credit lines and other commitments to lend subject to certain conditions being met by the counterparty. The Bank does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above show the timing of cash outflows to settle financial liabilities, prepared on the following basis:

Financial liabilities are included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If repayment is triggered by, or is subject to, specific criteria such as market price hurdles being reached, the liability is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note automatically prepays when an equity index exceeds a certain level, the cash outflow will be included in the less than three months' period whatever the level of the index at the year end. The settlement date of debt securities issued by certain securitisation vehicles consolidated by the Group depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

## Notes on the accounts

### 12 Financial instruments - maturity analysis continued

*Liabilities with a contractual maturity of greater than 20 years* - the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal, are excluded from the table along with interest payments after 20 years.

*Held-for-trading liabilities* - held-for-trading liabilities of £424.0 billion (2012 - £632.5 billion; 2011 - £717.5 billion) for the Group and £397.9 billion (2012 - £593.4 billion; 2011 - £698.3 billion) for the Bank, have been excluded from the table in view of their short-term nature.

### 13 Financial assets - impairments

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

|                                                    | Group                          |                                |              |            |            |            |
|----------------------------------------------------|--------------------------------|--------------------------------|--------------|------------|------------|------------|
|                                                    | Individually<br>assessed<br>£m | Collectively<br>assessed<br>£m | Latent<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| At 1 January                                       | 12,411                         | 6,475                          | 1,921        | 20,807     | 18,554     | 16,770     |
| Transfers (to)/from disposal groups                | —                              | —                              | (9)          | (9)        | 764        | (773)      |
| Currency translation and other adjustments         | 74                             | 35                             | 4            | 113        | (175)      | (261)      |
| Transfers from fellow subsidiaries                 | 33                             | —                              | —            | 33         | 415        | 3          |
| Disposals                                          | —                              | —                              | —            | —          | (1)        | —          |
| Amounts written-off                                | (2,534)                        | (1,690)                        | —            | (4,224)    | (3,887)    | (4,183)    |
| Recoveries of amounts previously written-off       | 89                             | 160                            | —            | 249        | 332        | 508        |
| Charge to income statement                         | 6,936                          | 1,456                          | 73           | 8,465      | 5,281      | 6,969      |
| Unwind of discount (recognised in interest income) | (258)                          | (131)                          | —            | (389)      | (476)      | (479)      |
| At 31 December <sup>(1)</sup>                      | 16,751                         | 6,305                          | 1,989        | 25,045     | 20,807     | 18,554     |

Note:

(1) Includes £62 million relating to loans and advances to banks (2012 - £114 million; 2011 - £85 million).

|                                                    | Bank                           |                                |              |            |            |            |
|----------------------------------------------------|--------------------------------|--------------------------------|--------------|------------|------------|------------|
|                                                    | Individually<br>assessed<br>£m | Collectively<br>assessed<br>£m | Latent<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| At 1 January                                       | 3,945                          | 1,170                          | 511          | 5,626      | 4,623      | 5,581      |
| Transfers from/(to) disposal groups                | —                              | —                              | —            | —          | 742        | (746)      |
| Currency translation and other adjustments         | 22                             | —                              | 1            | 23         | 152        | (28)       |
| Transfers from fellow subsidiaries                 | 33                             | —                              | —            | 33         | 415        | 3          |
| Amounts written-off                                | (1,616)                        | (327)                          | —            | (1,943)    | (1,928)    | (1,764)    |
| Recoveries of amounts previously written-off       | 27                             | 24                             | —            | 51         | 105        | 287        |
| Charge to income statement                         | 2,403                          | 168                            | (13)         | 2,558      | 1,645      | 1,425      |
| Unwind of discount (recognised in interest income) | (78)                           | (34)                           | —            | (112)      | (128)      | (135)      |
| At 31 December <sup>(1)</sup>                      | 4,736                          | 1,001                          | 499          | 6,236      | 5,626      | 4,623      |

Note:

(1) Includes £62 million relating to loans and advances to banks (2012 - £108 million; 2011 - £76 million).

|                                                          | Group      |            |            |
|----------------------------------------------------------|------------|------------|------------|
|                                                          | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| <b>Impairment losses charged to the income statement</b> |            |            |            |
| Loans and advances to customers                          | 8,480      | 5,270      | 6,969      |
| Loans and advances to banks                              | (15)       | 11         | —          |
|                                                          | 8,465      | 5,281      | 6,969      |
| Debt securities                                          | (16)       | (97)       | 172        |
| Equity shares                                            | —          | 30         | 35         |
|                                                          | (16)       | (67)       | 207        |
|                                                          | 8,449      | 5,214      | 7,176      |

## Notes on the accounts

### 13 Financial assets – impairments continued

|                                                                                                                 | Group        |              |              |
|-----------------------------------------------------------------------------------------------------------------|--------------|--------------|--------------|
|                                                                                                                 | 2013         | 2012         | 2011         |
|                                                                                                                 | £m           | £m           | £m           |
| Gross income not recognised but which would have been recognised under the original terms of the impaired loans |              |              |              |
| UK                                                                                                              | 570          | 660          | 634          |
| Overseas                                                                                                        | 657          | 899          | 905          |
|                                                                                                                 | <b>1,227</b> | <b>1,559</b> | <b>1,539</b> |
| Interest on impaired loans included in net interest income                                                      |              |              |              |
| UK                                                                                                              | 164          | 232          | 217          |
| Overseas                                                                                                        | 226          | 244          | 261          |
|                                                                                                                 | <b>390</b>   | <b>476</b>   | <b>478</b>   |

The following tables analyse impaired financial assets.

|                                     | 2013          |                 |                         | Group<br>2012 |                 |                         | 2011          |                 |                         |
|-------------------------------------|---------------|-----------------|-------------------------|---------------|-----------------|-------------------------|---------------|-----------------|-------------------------|
|                                     | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m |
| Loans and receivables               |               |                 |                         |               |                 |                         |               |                 |                         |
| Loans and advances to banks (1)     | 69            | 62              | 7                       | 134           | 114             | 20                      | 94            | 85              | 9                       |
| Loans and advances to customers (2) | 36,836        | 22,994          | 13,842                  | 37,754        | 18,772          | 18,982                  | 37,020        | 16,584          | 20,436                  |
|                                     | <b>36,905</b> | <b>23,056</b>   | <b>13,849</b>           | <b>37,888</b> | <b>18,886</b>   | <b>19,002</b>           | <b>37,114</b> | <b>16,669</b>   | <b>20,445</b>           |

|                               | Group                           |                                 |                                 |
|-------------------------------|---------------------------------|---------------------------------|---------------------------------|
|                               | Carrying<br>value<br>2013<br>£m | Carrying<br>value<br>2012<br>£m | Carrying<br>value<br>2011<br>£m |
| Available-for-sale securities |                                 |                                 |                                 |
| Debt securities               | 144                             | 222                             | 546                             |
| Equity shares                 | 30                              | 31                              | 57                              |
| Loans and receivables         |                                 |                                 |                                 |
| Debt securities               | 528                             | 902                             | 114                             |
|                               | <b>702</b>                      | <b>1,155</b>                    | <b>717</b>                      |

The following tables analyse impaired financial assets.

|                                     | 2013          |                 |                         | Bank<br>2012  |                 |                         | 2011          |                 |                         |
|-------------------------------------|---------------|-----------------|-------------------------|---------------|-----------------|-------------------------|---------------|-----------------|-------------------------|
|                                     | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m | Cost<br>£m    | Provision<br>£m | Carrying<br>value<br>£m |
| Loans and receivables               |               |                 |                         |               |                 |                         |               |                 |                         |
| Loans and advances to banks (1)     | 69            | 62              | 7                       | 127           | 108             | 19                      | 85            | 76              | 9                       |
| Loans and advances to customers (3) | 11,397        | 5,675           | 5,722                   | 12,320        | 5,007           | 7,313                   | 12,215        | 4,076           | 8,139                   |
|                                     | <b>11,466</b> | <b>5,737</b>    | <b>5,729</b>            | <b>12,447</b> | <b>5,115</b>    | <b>7,332</b>            | <b>12,300</b> | <b>4,152</b>    | <b>8,148</b>            |

For the notes to these tables refer to the following page.

## Notes on the accounts

### 13 Financial assets – impairments continued

|                                      | Bank                         |                              |                              |
|--------------------------------------|------------------------------|------------------------------|------------------------------|
|                                      | Carrying value<br>2013<br>£m | Carrying value<br>2012<br>£m | Carrying value<br>2011<br>£m |
| <b>Available-for-sale securities</b> |                              |                              |                              |
| Debt securities                      | 144                          | 222                          | 537                          |
| Equity shares                        | 8                            | 9                            | 9                            |
| <b>Loans and receivables</b>         |                              |                              |                              |
| Debt securities                      | 528                          | 902                          | 114                          |
|                                      | <b>680</b>                   | <b>1,133</b>                 | <b>660</b>                   |

Notes:

- (1) Impairment provisions individually assessed.  
(2) Impairment provisions individually assessed on balances of £26,681 million (2012 - £26,292 million; 2011 - £27,614 million).  
(3) Impairment provisions individually assessed on balances of £9,737 million (2011 - £10,235 million; 2011 - £10,889 million).

The following tables show financial and non-financial assets, recognised on the balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements.

|                      | Group      |            |            |
|----------------------|------------|------------|------------|
|                      | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Residential property | 18         | 67         | 60         |
| Other property       | 13         | 46         | 73         |
| Cash                 | 44         | 49         | 56         |
| Other assets         | 2          | 1          | 2          |
|                      | <b>77</b>  | <b>163</b> | <b>191</b> |

|                      | Bank       |            |            |
|----------------------|------------|------------|------------|
|                      | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Residential property | 13         | 15         | 23         |

In general, the Group seeks to dispose of property and other assets not readily convertible into cash, obtained by taking possession of collateral, as rapidly as the market for the individual asset permits.

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

|      | Group                       |                              |                              |                                      |             | Bank                        |                              |                              |                                      |             |
|------|-----------------------------|------------------------------|------------------------------|--------------------------------------|-------------|-----------------------------|------------------------------|------------------------------|--------------------------------------|-------------|
|      | Past due<br>1-29 days<br>£m | Past due<br>30-59 days<br>£m | Past due<br>60-89 days<br>£m | Past due<br>90 days<br>or more<br>£m | Total<br>£m | Past due<br>1-29 days<br>£m | Past due<br>30-59 days<br>£m | Past due<br>60-89 days<br>£m | Past due<br>90 days<br>or more<br>£m | Total<br>£m |
| 2013 | 4,765                       | 1,260                        | 822                          | 2,221                                | 9,068       | 563                         | 260                          | 142                          | 937                                  | 1,902       |
| 2012 | 5,599                       | 1,117                        | 1,177                        | 2,637                                | 10,530      | 665                         | 120                          | 532                          | 962                                  | 2,279       |
| 2011 | 6,184                       | 1,633                        | 1,004                        | 1,958                                | 10,779      | 653                         | 213                          | 131                          | 477                                  | 1,474       |

These balances include loans and advances to customers that are past due through administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

## Notes on the accounts

### 14 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, interest rate and credit risk.

The Group enters into fair value hedges, cash flow hedges and hedges of net investments in foreign operations. The majority of the Group's interest rate hedges relate to the management of the Group's non-trading interest rate risk. The Group manages this risk to within approval limits. Residual risk positions are hedged with derivatives principally interest rate swaps. Suitable larger ticket financial instruments are fair value hedged; the remaining exposure, where possible, is hedged by derivatives documented as cash flow hedges and qualifying for hedge accounting. The majority of the Group's fair value hedges involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Cash flow hedges relate to exposure to the variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities. The Group hedges its net investments in foreign operations with currency borrowings and forward exchange contracts.

For cash flow hedge relationships of interest rate risk, the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR, EURIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities. At 31 December 2013, variable rate financial assets of £74 billion (2012 - £60 billion; 2011 - £49 billion) for the Group and £49 billion (2012 - £48 billion; 2011 - £37 million) for the Bank, and variable rate financial liabilities of £10 billion (2012 - £8 billion; 2011 - £12 billion) for the Group and £3 billion (2012 and 2011 - £4 billion) for the Bank were hedged in such cash flow hedge relationships.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk, the hedged items are typically government bonds, large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. At 31 December 2013, fixed rate financial assets of £17 billion (2012 - £16 billion; 2011 - £17 billion) for the Group and £12 billion (2012 - £9 billion; 2011 - £10 billion) for the Bank, and fixed rate financial liabilities of £29 billion (2012 - £34 billion; 2011 - £36 billion) for the Group and £29 billion (2012 - £31 billion; 2011 - £35 billion) for the Bank were hedged by interest rate swaps in fair value hedge relationships.

The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

The following table shows the notional amounts and fair values of the Group's derivatives:

|                                       | 2013                      |                |                   | Group<br>2012             |                |                   | 2011                      |                |                   |
|---------------------------------------|---------------------------|----------------|-------------------|---------------------------|----------------|-------------------|---------------------------|----------------|-------------------|
|                                       | Notional<br>amount<br>£bn | Assets<br>£m   | Liabilities<br>£m | Notional<br>amount<br>£bn | Assets<br>£m   | Liabilities<br>£m | Notional<br>amount<br>£bn | Assets<br>£m   | Liabilities<br>£m |
| <b>Exchange rate contracts</b>        |                           |                |                   |                           |                |                   |                           |                |                   |
| Spot, forwards and futures            | 2,040                     | 24,392         | 24,087            | 2,243                     | 23,083         | 22,700            | 2,097                     | 30,316         | 28,917            |
| Currency swaps                        | 949                       | 18,514         | 22,656            | 1,051                     | 21,785         | 29,993            | 1,044                     | 24,482         | 34,499            |
| Options purchased                     | 791                       | 18,826         | —                 | 682                       | 17,558         | —                 | 640                       | 19,098         | —                 |
| Options written                       | 766                       | —              | 18,721            | 684                       | —              | 17,487            | 641                       | —              | 18,597            |
| <b>Interest rate contracts</b>        |                           |                |                   |                           |                |                   |                           |                |                   |
| Interest rate swaps                   | 27,501                    | 181,043        | 172,998           | 25,465                    | 303,697        | 287,515           | 29,965                    | 348,986        | 334,118           |
| Options purchased                     | 1,568                     | 37,437         | —                 | 1,934                     | 61,794         | —                 | 2,398                     | 74,590         | —                 |
| Options written                       | 1,514                     | —              | 35,436            | 1,884                     | —              | 58,336            | 2,593                     | —              | 72,058            |
| Futures and forwards                  | 5,025                     | 712            | 669               | 4,191                     | 748            | 653               | 3,757                     | 876            | 744               |
| <b>Credit derivatives</b>             |                           |                |                   |                           |                |                   |                           |                |                   |
|                                       | 253                       | 5,359          | 5,422             | 552                       | 10,995         | 10,363            | 1,063                     | 27,017         | 26,750            |
| <b>Equity and commodity contracts</b> |                           |                |                   |                           |                |                   |                           |                |                   |
|                                       | 81                        | 3,120          | 6,144             | 116                       | 5,441          | 9,038             | 127                       | 7,442          | 12,153            |
|                                       |                           | <b>289,403</b> | <b>286,133</b>    |                           | <b>445,101</b> | <b>436,085</b>    |                           | <b>532,807</b> | <b>527,836</b>    |

## Notes on the accounts

### 14 Derivatives continued

|                                 | Group        |                   |              |                   |              |                   |
|---------------------------------|--------------|-------------------|--------------|-------------------|--------------|-------------------|
|                                 | 2013         |                   | 2012         |                   | 2011         |                   |
|                                 | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m |
| Amounts above include:          |              |                   |              |                   |              |                   |
| Due from/to holding company     | 53           | 153               | 7            | 511               | 79           | 1,502             |
| Due from/to fellow subsidiaries | 3,360        | 2,433             | 7,193        | 5,069             | 10,301       | 9,875             |

Included in the table above are derivatives held for hedging purposes as follows:

|                               | Group        |                   |              |                   |              |                   |
|-------------------------------|--------------|-------------------|--------------|-------------------|--------------|-------------------|
|                               | 2013         |                   | 2012         |                   | 2011         |                   |
|                               | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m |
| <b>Fair value hedging</b>     |              |                   |              |                   |              |                   |
| Interest rate contracts       | 1,917        | 1,495             | 3,398        | 2,554             | 2,968        | 2,524             |
| <b>Cash flow hedging</b>      |              |                   |              |                   |              |                   |
| Interest rate contracts       | 2,390        | 1,602             | 4,814        | 1,074             | 3,964        | 1,270             |
| <b>Net investment hedging</b> |              |                   |              |                   |              |                   |
| Exchange rate contracts       | 28           | 21                | 1            | 14                | 120          | 5                 |

Hedge ineffectiveness recognised in other operating income comprised:

|                                                                    | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|--------------------------------------------------------------------|------------|------------|------------|
| <b>Fair value hedging</b>                                          |            |            |            |
| Gains/(losses) on the hedged items attributable to the hedged risk | 134        | (141)      | 212        |
| (Losses)/gains on the hedging instruments                          | (164)      | 188        | (193)      |
| Fair value hedging ineffectiveness                                 | (30)       | 47         | 19         |
| Cash flow hedging ineffectiveness                                  | (64)       | 25         | 20         |
|                                                                    | (94)       | 72         | 39         |

## Notes on the accounts

### 14 Derivatives continued

The following table shows, when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

|                                                     | Group                     |                 |                   |                           |                 |                   |                           |                     |                   |
|-----------------------------------------------------|---------------------------|-----------------|-------------------|---------------------------|-----------------|-------------------|---------------------------|---------------------|-------------------|
|                                                     | 0-1 years<br>£m           | 1-2 years<br>£m | 2-3 years<br>£m   | 3-4 years<br>£m           | 4-5 years<br>£m | 5-10 years<br>£m  | 10-20 years<br>£m         | Over 20 years<br>£m | Total<br>£m       |
| 2013                                                |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Hedged forecast cash flows expected to occur        |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 303                       | 284             | 243               | 206                       | 144             | 271               | —                         | —                   | 1,451             |
| Forecast payable cash flows                         | (33)                      | (22)            | (18)              | (15)                      | (14)            | (64)              | (101)                     | (19)                | (286)             |
| Hedged forecast cash flows affect on profit or loss |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 302                       | 281             | 239               | 201                       | 138             | 261               | —                         | —                   | 1,422             |
| Forecast payable cash flows                         | (32)                      | (22)            | (18)              | (16)                      | (13)            | (64)              | (101)                     | (19)                | (285)             |
| 2012                                                |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Hedged forecast cash flows expected to occur        |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 282                       | 256             | 229               | 174                       | 135             | 186               | —                         | —                   | 1,262             |
| Forecast payable cash flows                         | (32)                      | (21)            | (13)              | (11)                      | (11)            | (58)              | (103)                     | (29)                | (278)             |
| Hedged forecast cash flows affect on profit or loss |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 274                       | 254             | 222               | 169                       | 130             | 176               | —                         | —                   | 1,225             |
| Forecast payable cash flows                         | (31)                      | (20)            | (12)              | (11)                      | (11)            | (59)              | (103)                     | (29)                | (276)             |
| 2011                                                |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Hedged forecast cash flows expected to occur        |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 401                       | 409             | 354               | 300                       | 195             | 264               | —                         | —                   | 1,923             |
| Forecast payable cash flows                         | (79)                      | (66)            | (33)              | (30)                      | (31)            | (145)             | (192)                     | (57)                | (633)             |
| Hedged forecast cash flows affect on profit or loss |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Forecast receivable cash flows                      | 416                       | 396             | 349               | 285                       | 183             | 249               | —                         | —                   | 1,878             |
| Forecast payable cash flows                         | (81)                      | (62)            | (32)              | (30)                      | (30)            | (147)             | (192)                     | (56)                | (630)             |
|                                                     | Bank                      |                 |                   |                           |                 |                   |                           |                     |                   |
|                                                     | 2013                      |                 |                   | 2012                      |                 |                   | 2011                      |                     |                   |
|                                                     | Notional<br>amount<br>£bn | Assets<br>£m    | Liabilities<br>£m | Notional<br>amount<br>£bn | Assets<br>£m    | Liabilities<br>£m | Notional<br>amount<br>£bn | Assets<br>£m        | Liabilities<br>£m |
| Exchange rate contracts                             |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Spot, forwards and futures                          | 2,056                     | 24,454          | 24,692            | 2,248                     | 23,125          | 22,737            | 2,110                     | 30,432              | 29,168            |
| Currency swaps                                      | 960                       | 19,110          | 22,654            | 1,067                     | 22,733          | 29,990            | 1,059                     | 24,802              | 35,097            |
| Options purchased                                   | 792                       | 18,844          | —                 | 683                       | 17,571          | —                 | 641                       | 19,121              | —                 |
| Options written                                     | 767                       | —               | 18,740            | 684                       | —               | 17,500            | 642                       | —                   | 18,620            |
| Interest rate contracts                             |                           |                 |                   |                           |                 |                   |                           |                     |                   |
| Interest rate swaps                                 | 27,238                    | 183,892         | 174,682           | 25,512                    | 307,523         | 290,431           | 29,988                    | 353,177             | 336,267           |
| Options purchased                                   | 1,564                     | 37,398          | —                 | 1,918                     | 61,659          | —                 | 2,405                     | 74,487              | —                 |
| Options written                                     | 1,516                     | —               | 35,476            | 1,888                     | —               | 58,385            | 2,592                     | —                   | 72,091            |
| Futures and forwards                                | 4,869                     | 648             | 612               | 4,156                     | 721             | 644               | 3,703                     | 862                 | 735               |
| Credit derivatives                                  | 254                       | 5,402           | 5,416             | 552                       | 11,062          | 10,363            | 1,063                     | 27,017              | 26,682            |
| Equity and commodity contracts                      | 81                        | 3,132           | 6,235             | 116                       | 5,444           | 9,102             | 124                       | 7,399               | 12,195            |
|                                                     |                           | 292,880         | 288,507           |                           | 449,838         | 439,152           |                           | 537,297             | 530,855           |



## Notes on the accounts

### 14 Derivatives continued

|                                 | 2013   |             | Bank<br>2012 |             | 2011   |             |
|---------------------------------|--------|-------------|--------------|-------------|--------|-------------|
|                                 | Assets | Liabilities | Assets       | Liabilities | Assets | Liabilities |
|                                 | £m     | £m          | £m           | £m          | £m     | £m          |
| Amounts above include:          |        |             |              |             |        |             |
| Due from/to holding company     | 53     | 153         | 7            | 511         | 79     | 1,502       |
| Due from/to fellow subsidiaries | 3,359  | 2,433       | 7,186        | 5,069       | 10,297 | 9,870       |
| Due from/to subsidiaries        | 5,555  | 3,089       | 7,760        | 3,741       | 8,081  | 4,133       |

Included in the table above are derivatives held for hedging purposes as follows:

|                         | 2013   |             | Bank<br>2012 |             | 2011   |             |
|-------------------------|--------|-------------|--------------|-------------|--------|-------------|
|                         | Assets | Liabilities | Assets       | Liabilities | Assets | Liabilities |
|                         | £m     | £m          | £m           | £m          | £m     | £m          |
| Fair value hedging      |        |             |              |             |        |             |
| Exchange rate contracts | 23     | 8           | 1            | 5           | —      | —           |
| Interest rate contracts | 1,818  | 864         | 2,945        | 1,189       | 2,711  | 1,248       |
| Cash flow hedging       |        |             |              |             |        |             |
| Interest rate contracts | 1,767  | 878         | 3,678        | 554         | 3,088  | 503         |
| Net investment hedging  |        |             |              |             |        |             |
| Exchange rate contracts | 5      | 1           | —            | 1           | —      | —           |

The following table shows, when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges.

|                                                     | Bank            |                 |                 |                 |                 |                  |                   |                     |             |
|-----------------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|-------------------|---------------------|-------------|
|                                                     | 0-1 years<br>£m | 1-2 years<br>£m | 2-3 years<br>£m | 3-4 years<br>£m | 4-5 years<br>£m | 5-10 years<br>£m | 10-20 years<br>£m | Over 20 years<br>£m | Total<br>£m |
| 2013                                                |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Hedged forecast cash flows expected to occur        |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 199             | 184             | 152             | 126             | 84              | 129              | —                 | —                   | 874         |
| Forecast payable cash flows                         | (11)            | (8)             | (8)             | (7)             | (8)             | (39)             | (71)              | (9)                 | (161)       |
| Hedged forecast cash flows affect on profit or loss |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 198             | 181             | 149             | 122             | 79              | 123              | —                 | —                   | 852         |
| Forecast payable cash flows                         | (10)            | (8)             | (8)             | (8)             | (8)             | (39)             | (71)              | (9)                 | (161)       |
| 2012                                                |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Hedged forecast cash flows expected to occur        |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 226             | 202             | 180             | 135             | 106             | 148              | —                 | —                   | 997         |
| Forecast payable cash flows                         | (21)            | (12)            | (8)             | (7)             | (7)             | (39)             | (72)              | (15)                | (181)       |
| Hedged forecast cash flows affect on profit or loss |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 219             | 200             | 174             | 131             | 101             | 141              | —                 | —                   | 966         |
| Forecast payable cash flows                         | (20)            | (11)            | (8)             | (7)             | (7)             | (40)             | (72)              | (15)                | (180)       |
| 2011                                                |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Hedged forecast cash flows expected to occur        |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 311             | 318             | 276             | 228             | 136             | 174              | —                 | —                   | 1,443       |
| Forecast payable cash flows                         | (22)            | (22)            | (10)            | (7)             | (8)             | (37)             | (73)              | (23)                | (202)       |
| Hedged forecast cash flows affect on profit or loss |                 |                 |                 |                 |                 |                  |                   |                     |             |
| Forecast receivable cash flows                      | 321             | 308             | 271             | 214             | 127             | 162              | —                 | —                   | 1,403       |
| Forecast payable cash flows                         | (25)            | (20)            | (9)             | (7)             | (7)             | (39)             | (73)              | (22)                | (202)       |

## Notes on the accounts

### 15 Debt securities

|                                                    | Group                        |          |             |             |                              |           |         |                  |
|----------------------------------------------------|------------------------------|----------|-------------|-------------|------------------------------|-----------|---------|------------------|
|                                                    | Central and local government |          |             |             | Other financial institutions | Corporate | Total   | Of which ABS (1) |
|                                                    | UK<br>£m                     | US<br>£m | Other<br>£m | Banks<br>£m | £m                           | £m        | £m      | £m               |
| 2013                                               |                              |          |             |             |                              |           |         |                  |
| Held-for-trading                                   | 6,764                        | 10,945   | 22,557      | 1,608       | 12,407                       | 1,977     | 56,258  | 10,674           |
| Designated as at fair value through profit or loss | —                            | —        | —           | —           | 14                           | —         | 14      | 14               |
| Available-for-sale                                 | 6,436                        | 11,456   | 6,824       | 2,531       | 13,290                       | 145       | 40,682  | 16,976           |
| Loans and receivables                              | 10                           | 1        | —           | 169         | 3,426                        | 136       | 3,742   | 3,423            |
|                                                    | 13,210                       | 22,402   | 29,381      | 4,308       | 29,137                       | 2,258     | 100,696 | 31,087           |

#### Available-for-sale

|                         |      |      |      |     |       |     |       |       |
|-------------------------|------|------|------|-----|-------|-----|-------|-------|
| Gross unrealised gains  | 201  | 272  | 106  | 2   | 333   | 9   | 923   | 361   |
| Gross unrealised losses | (69) | (86) | (25) | (1) | (196) | (1) | (378) | (252) |

#### 2012

|                                                    |        |        |        |       |        |       |         |        |
|----------------------------------------------------|--------|--------|--------|-------|--------|-------|---------|--------|
| Held-for-trading                                   | 7,692  | 17,303 | 26,344 | 2,036 | 21,722 | 1,933 | 77,030  | 18,619 |
| Designated as at fair value through profit or loss | —      | —      | —      | 86    | 610    | 1     | 697     | 516    |
| Available-for-sale                                 | 7,950  | 17,514 | 10,083 | 2,933 | 15,967 | 114   | 54,561  | 18,953 |
| Loans and receivables                              | 5      | —      | —      | 327   | 3,683  | 282   | 4,297   | 3,663  |
|                                                    | 15,647 | 34,817 | 36,427 | 5,382 | 41,982 | 2,330 | 136,585 | 41,751 |

#### Available-for-sale

|                         |     |     |     |     |       |   |       |       |
|-------------------------|-----|-----|-----|-----|-------|---|-------|-------|
| Gross unrealised gains  | 944 | 861 | 579 | 17  | 582   | 8 | 2,991 | 647   |
| Gross unrealised losses | —   | (1) | —   | (1) | (122) | — | (124) | (124) |

#### 2011

|                                                    |        |        |        |       |        |       |         |        |
|----------------------------------------------------|--------|--------|--------|-------|--------|-------|---------|--------|
| Held-for-trading                                   | 9,004  | 18,770 | 35,146 | 3,649 | 22,577 | 2,615 | 91,761  | 20,815 |
| Designated as at fair value through profit or loss | 1      | —      | —      | 53    | 457    | 9     | 520     | 418    |
| Available-for-sale                                 | 10,654 | 18,769 | 13,987 | 4,624 | 22,907 | 451   | 71,392  | 25,996 |
| Loans and receivables                              | 10     | —      | —      | 32    | 5,093  | 333   | 5,468   | 5,057  |
|                                                    | 19,669 | 37,539 | 49,133 | 8,358 | 51,034 | 3,408 | 169,141 | 52,286 |

#### Available-for-sale

|                         |       |     |     |      |       |      |       |       |
|-------------------------|-------|-----|-----|------|-------|------|-------|-------|
| Gross unrealised gains  | 1,312 | 967 | 700 | 3    | 874   | 9    | 3,865 | 952   |
| Gross unrealised losses | —     | —   | —   | (32) | (326) | (12) | (370) | (336) |

Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

Gross gains of £1,044 million (2012 - £1,696 million; 2011 - £786 million) and gross losses of £48 million (2012 - £30 million; 2011 - £58 million) were realised on the sale of available-for-sale securities.

## Notes on the accounts

### 15 Debt securities continued

|                                                    | Bank                         |          |             |       |                              |           |        |                  |
|----------------------------------------------------|------------------------------|----------|-------------|-------|------------------------------|-----------|--------|------------------|
|                                                    | Central and local government |          |             | Banks | Other financial institutions | Corporate | Total  | Of which ABS (1) |
|                                                    | UK<br>£m                     | US<br>£m | Other<br>£m |       |                              |           |        |                  |
| 2013                                               |                              |          |             |       |                              |           |        |                  |
| Held-for-trading                                   | 6,764                        | 1,234    | 20,269      | 1,356 | 3,745                        | 1,044     | 34,412 | 2,150            |
| Designated as at fair value through profit or loss | —                            | —        | —           | —     | 456                          | —         | 456    | 456              |
| Available-for-sale                                 | 6,436                        | 6,718    | 6,452       | 2,139 | 6,396                        | 110       | 28,251 | 4,725            |
| Loans and receivables                              | 6                            | —        | —           | 169   | 28,897                       | 136       | 29,208 | 28,893           |
|                                                    | 13,206                       | 7,952    | 26,721      | 3,664 | 39,494                       | 1,290     | 92,327 | 36,224           |

#### Available-for-sale

|                         |      |      |      |     |       |   |       |       |
|-------------------------|------|------|------|-----|-------|---|-------|-------|
| Gross unrealised gains  | 201  | 240  | 105  | 2   | 224   | — | 772   | 220   |
| Gross unrealised losses | (69) | (29) | (25) | (1) | (112) | — | (236) | (112) |

#### 2012

|                                                    |        |        |        |       |        |       |         |        |
|----------------------------------------------------|--------|--------|--------|-------|--------|-------|---------|--------|
| Held-for-trading                                   | 7,692  | 4,174  | 23,458 | 1,615 | 4,974  | 986   | 42,899  | 2,446  |
| Designated as at fair value through profit or loss | —      | —      | —      | 86    | 1,156  | —     | 1,242   | 1,062  |
| Available-for-sale                                 | 7,950  | 13,989 | 9,477  | 2,829 | 8,725  | 89    | 43,059  | 7,555  |
| Loans and receivables                              | —      | —      | —      | 327   | 34,638 | 282   | 35,247  | 34,618 |
|                                                    | 15,642 | 18,163 | 32,935 | 4,857 | 49,493 | 1,357 | 122,447 | 45,681 |

#### Available-for-sale

|                         |     |     |     |     |       |   |       |       |
|-------------------------|-----|-----|-----|-----|-------|---|-------|-------|
| Gross unrealised gains  | 944 | 775 | 577 | 17  | 326   | 6 | 2,645 | 307   |
| Gross unrealised losses | —   | —   | —   | (1) | (122) | — | (123) | (123) |

#### 2011

|                                                    |        |        |        |       |        |       |         |        |
|----------------------------------------------------|--------|--------|--------|-------|--------|-------|---------|--------|
| Held-for-trading                                   | 9,004  | 2,266  | 31,410 | 2,473 | 4,862  | 1,655 | 51,670  | 3,563  |
| Designated as at fair value through profit or loss | —      | —      | —      | 49    | 1,216  | 1     | 1,266   | 1,237  |
| Available-for-sale                                 | 10,654 | 16,051 | 13,497 | 4,502 | 12,250 | 334   | 57,288  | 11,838 |
| Loans and receivables                              | 6      | —      | —      | 285   | 70,614 | 331   | 71,236  | 70,834 |
|                                                    | 19,664 | 18,317 | 44,907 | 7,309 | 88,942 | 2,321 | 181,460 | 87,472 |

#### Available-for-sale

|                         |       |     |     |      |       |      |       |       |
|-------------------------|-------|-----|-----|------|-------|------|-------|-------|
| Gross unrealised gains  | 1,312 | 862 | 690 | 2    | 587   | 2    | 3,455 | 563   |
| Gross unrealised losses | —     | —   | —   | (29) | (267) | (11) | (307) | (277) |

#### Note:

(1) Includes asset-backed securities issued by US federal agencies and government sponsored entities, and covered bonds.

## Notes on the accounts

### 16 Equity shares

|                                                       | 2013         |                |             | Group<br>2012 |                |             | 2011         |                |             |
|-------------------------------------------------------|--------------|----------------|-------------|---------------|----------------|-------------|--------------|----------------|-------------|
|                                                       | Listed<br>£m | Unlisted<br>£m | Total<br>£m | Listed<br>£m  | Unlisted<br>£m | Total<br>£m | Listed<br>£m | Unlisted<br>£m | Total<br>£m |
| Held-for-trading                                      | 6,904        | 79             | 6,983       | 12,255        | 56             | 12,311      | 9,779        | 65             | 9,844       |
| Designated as at fair value<br>through profit or loss | 141          | 172            | 313         | 243           | 241            | 484         | 336          | 239            | 575         |
| Available-for-sale                                    | 195          | 787            | 982         | 182           | 895            | 1,077       | 215          | 1,128          | 1,343       |
|                                                       | 7,240        | 1,038          | 8,278       | 12,680        | 1,192          | 13,872      | 10,330       | 1,432          | 11,762      |

#### Available-for-sale

|                         |     |      |      |      |      |      |      |      |      |
|-------------------------|-----|------|------|------|------|------|------|------|------|
| Gross unrealised gains  | 73  | 96   | 169  | 56   | 86   | 142  | 50   | 185  | 235  |
| Gross unrealised losses | (9) | (10) | (19) | (53) | (13) | (66) | (18) | (21) | (39) |

Gross gains of £51 million (2012 - £138 million; 2011 - £139 million) and gross losses of £12 million (2012 - £1 million; 2011 - nil) were realised on the sale of available-for-sale equity shares.

Dividend income from available-for-sale equity shares was £83 million (2012 - £234 million; 2011 - £216 million).

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include capital stock (redeemable at cost) in the Federal Home Loan Bank and Federal Reserve Bank of £0.6 billion (2012 - £0.7 billion; 2011 - £0.7 billion), together with a number of individually small shareholdings. Disposals in the year generated no gains or losses (2012 - £2 million gains; 2011 - £2 million gains).

|                                                       | 2013         |                |             | Bank<br>2012 |                |             | 2011         |                |             |
|-------------------------------------------------------|--------------|----------------|-------------|--------------|----------------|-------------|--------------|----------------|-------------|
|                                                       | Listed<br>£m | Unlisted<br>£m | Total<br>£m | Listed<br>£m | Unlisted<br>£m | Total<br>£m | Listed<br>£m | Unlisted<br>£m | Total<br>£m |
| Held-for-trading                                      | 6,901        | 48             | 6,949       | 12,230       | 48             | 12,278      | 9,736        | 57             | 9,793       |
| Designated as at fair value<br>through profit or loss | 84           | 23             | 107         | 214          | 60             | 274         | 300          | 29             | 329         |
| Available-for-sale                                    | 142          | 103            | 245         | 140          | 74             | 214         | 190          | 174            | 364         |
|                                                       | 7,127        | 174            | 7,301       | 12,584       | 182            | 12,766      | 10,226       | 260            | 10,486      |

#### Available-for-sale

|                         |     |     |     |      |     |      |      |     |      |
|-------------------------|-----|-----|-----|------|-----|------|------|-----|------|
| Gross unrealised gains  | 36  | 28  | 64  | 30   | 21  | 51   | 40   | 76  | 116  |
| Gross unrealised losses | (6) | (1) | (7) | (51) | (1) | (52) | (15) | (1) | (16) |

## Notes on the accounts

### 17 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

|                                                 | Bank       |            |            |
|-------------------------------------------------|------------|------------|------------|
|                                                 | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| At 1 January                                    | 40,262     | 32,164     | 27,504     |
| Currency translation and other adjustments      | (94)       | (103)      | 21         |
| Additional investments in Group undertakings    | 2,300      | 8,287      | 5,238      |
| Additions                                       | —          | —          | 59         |
| Redemption of investments in Group undertakings | —          | (123)      | (618)      |
| Disposals                                       | (54)       | (83)       | —          |
| (Impairment)/write-back of investments          | (86)       | 120        | (40)       |
| At 31 December                                  | 42,328     | 40,262     | 32,164     |

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest. All of the subsidiary undertakings are owned directly, or indirectly through intermediate holding companies, and are all wholly-owned. All of these subsidiaries are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

|                                                   | Nature of business | Country of incorporation and principal area of operation |
|---------------------------------------------------|--------------------|----------------------------------------------------------|
| National Westminster Bank Plc <sup>(1)</sup>      | Banking            | Great Britain                                            |
| RBS Citizens Financial Group, Inc. <sup>(3)</sup> | Banking            | US                                                       |
| Coutts & Company <sup>(2, 3)</sup>                | Private Banking    | Great Britain                                            |
| RBS Securities Inc <sup>(3)</sup>                 | Broker dealer      | US                                                       |
| Ulster Bank Limited <sup>(3, 4)</sup>             | Banking            | Northern Ireland                                         |

Notes:

- (1) The Bank does not hold any of the NatWest preference shares in issue.
- (2) Coutts & Company is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.
- (3) Shares are not directly held by the Bank.
- (4) Ulster Bank Limited and its subsidiary undertakings also operate in the Republic of Ireland.

The above information is provided in relation to the principal related undertakings as permitted by section 410(2) of the Companies Act 2006. Full information on all related undertakings will be included in the Annual Return delivered to the Registrar of Companies for Scotland.

### 18 Intangible assets

|                                                    | Group          |                                   |                                         |                                           | Total<br>£m |
|----------------------------------------------------|----------------|-----------------------------------|-----------------------------------------|-------------------------------------------|-------------|
|                                                    | Goodwill<br>£m | Core deposit<br>intangibles<br>£m | Other<br>purchased<br>intangibles<br>£m | Internally<br>generated<br>software<br>£m |             |
| 2013                                               |                |                                   |                                         |                                           |             |
| <b>Cost</b>                                        |                |                                   |                                         |                                           |             |
| At 1 January                                       | 17,910         | 49                                | 363                                     | 4,792                                     | 23,114      |
| Transfers from fellow subsidiaries                 | —              | —                                 | —                                       | 70                                        | 70          |
| Currency translation and other adjustments         | (164)          | —                                 | (7)                                     | (14)                                      | (185)       |
| Additions                                          | —              | —                                 | 29                                      | 935                                       | 964         |
| Disposals and write-off of fully amortised assets  | (18)           | (1)                               | —                                       | (1,306)                                   | (1,325)     |
| At 31 December                                     | 17,728         | 48                                | 385                                     | 4,477                                     | 22,638      |
| <b>Accumulated amortisation and impairment</b>     |                |                                   |                                         |                                           |             |
| At 1 January                                       | 7,487          | 27                                | 275                                     | 2,922                                     | 10,711      |
| Transfers from fellow subsidiaries                 | —              | —                                 | —                                       | 54                                        | 54          |
| Currency translation and other adjustments         | (80)           | 15                                | (35)                                    | (16)                                      | (116)       |
| Disposals and write-off of fully amortised assets  | (17)           | (1)                               | —                                       | (1,200)                                   | (1,218)     |
| Charge for the year                                | —              | 2                                 | 33                                      | 397                                       | 432         |
| Write down of goodwill and other intangible assets | 208            | —                                 | —                                       | 215                                       | 423         |
| At 31 December                                     | 7,598          | 43                                | 273                                     | 2,372                                     | 10,286      |
| Net book value at 31 December                      | 10,130         | 5                                 | 112                                     | 2,105                                     | 12,352      |

## Notes on the accounts

### 18 Intangible assets continued

|                                                    | Group    |                             |                                   |                                     |         |
|----------------------------------------------------|----------|-----------------------------|-----------------------------------|-------------------------------------|---------|
|                                                    | Goodwill | Core deposit<br>intangibles | Other<br>purchased<br>intangibles | Internally<br>generated<br>software | Total   |
|                                                    | £m       | £m                          | £m                                | £m                                  | £m      |
| <b>2012</b>                                        |          |                             |                                   |                                     |         |
| <b>Cost</b>                                        |          |                             |                                   |                                     |         |
| At 1 January                                       | 18,224   | 365                         | 420                               | 4,900                               | 23,909  |
| Transfers from/(to) fellow subsidiaries            | 5        | —                           | (7)                               | 242                                 | 240     |
| Transfers from disposal groups                     | 80       | —                           | —                                 | —                                   | 80      |
| Currency translation and other adjustments         | (294)    | (9)                         | (16)                              | (21)                                | (340)   |
| Additions                                          | —        | —                           | 39                                | 797                                 | 836     |
| Disposals and write-off of fully amortised assets  | (105)    | (307)                       | (73)                              | (1,126)                             | (1,611) |
| At 31 December                                     | 17,910   | 49                          | 363                               | 4,792                               | 23,114  |
| <b>Accumulated amortisation and impairment</b>     |          |                             |                                   |                                     |         |
| At 1 January                                       | 7,562    | 341                         | 317                               | 3,324                               | 11,544  |
| Transfers (to)/from fellow subsidiaries            | —        | —                           | (5)                               | 215                                 | 210     |
| Transfers from disposal groups                     | 80       | —                           | —                                 | —                                   | 80      |
| Currency translation and other adjustments         | (119)    | (9)                         | (11)                              | (10)                                | (149)   |
| Disposals and write-off of fully amortised assets  | (72)     | (307)                       | (73)                              | (1,123)                             | (1,575) |
| Charge for the year                                | —        | 2                           | 39                                | 509                                 | 550     |
| Write down of goodwill and other intangible assets | 36       | —                           | 8                                 | 7                                   | 51      |
| At 31 December                                     | 7,487    | 27                          | 275                               | 2,922                               | 10,711  |
| Net book value at 31 December                      | 10,423   | 22                          | 88                                | 1,870                               | 12,403  |

### 2011

|                                                    |        |     |     |       |        |
|----------------------------------------------------|--------|-----|-----|-------|--------|
| <b>Cost</b>                                        |        |     |     |       |        |
| At 1 January                                       | 18,292 | 349 | 385 | 3,995 | 23,021 |
| Transfers to fellow subsidiary                     | (95)   | —   | —   | —     | (95)   |
| Transfers to disposal groups                       | —      | —   | —   | (83)  | (83)   |
| Currency translation and other adjustments         | 9      | 16  | 1   | 73    | 99     |
| Acquisition of subsidiaries                        | 18     | —   | —   | —     | 18     |
| Additions                                          | —      | —   | 34  | 934   | 968    |
| Disposals and write-off of fully amortised assets  | —      | —   | —   | (19)  | (19)   |
| At 31 December                                     | 18,224 | 365 | 420 | 4,900 | 23,909 |
| <b>Accumulated amortisation and impairment</b>     |        |     |     |       |        |
| At 1 January                                       | 7,567  | 338 | 248 | 3,036 | 11,189 |
| Transfers to disposal groups                       | (80)   | —   | —   | —     | (80)   |
| Transfers to fellow subsidiaries                   | —      | —   | —   | (35)  | (35)   |
| Currency translation and other adjustments         | (5)    | —   | 4   | 15    | 14     |
| Disposals and write-off of fully amortised assets  | —      | —   | —   | (17)  | (17)   |
| Charge for the year                                | —      | 3   | 65  | 325   | 393    |
| Write down of goodwill and other intangible assets | 80     | —   | —   | —     | 80     |
| At 31 December                                     | 7,562  | 341 | 317 | 3,324 | 11,544 |
| Net book value at 31 December                      | 10,662 | 24  | 103 | 1,576 | 12,365 |

## Notes on the accounts

### 18 Intangible assets continued

|                                                    |          | Bank                          |         |
|----------------------------------------------------|----------|-------------------------------|---------|
|                                                    | Goodwill | Internally generated software | Total   |
|                                                    | £m       | £m                            | £m      |
| 2013                                               |          |                               |         |
| Cost                                               |          |                               |         |
| At 1 January                                       | 131      | 1,652                         | 1,783   |
| Currency translation and other adjustments         | 1        | 2                             | 3       |
| Transfers to subsidiaries                          | —        | (80)                          | (80)    |
| Additions                                          | —        | 779                           | 779     |
| Disposals and write-off of fully amortised assets  | (19)     | (1,294)                       | (1,313) |
| At 31 December                                     | 113      | 1,059                         | 1,172   |
| Accumulated amortisation and impairment            |          |                               |         |
| At 1 January                                       | 30       | 720                           | 750     |
| Currency translation and other adjustments         | 1        | 5                             | 6       |
| Transfers from fellow subsidiaries                 | —        | 22                            | 22      |
| Disposals and write-off of fully amortised assets  | (19)     | (1,193)                       | (1,212) |
| Charge for the year                                | —        | 252                           | 252     |
| Write down of goodwill and other intangible assets | 16       | 211                           | 227     |
| At 31 December                                     | 28       | 17                            | 45      |
| Net book value at 31 December                      | 85       | 1,042                         | 1,127   |
| 2012                                               |          |                               |         |
| Cost                                               |          |                               |         |
| At 1 January                                       | 126      | 1,988                         | 2,114   |
| Transfers from subsidiary                          | 5        | 160                           | 165     |
| Additions                                          | —        | 627                           | 627     |
| Disposals and write-off of fully amortised assets  | —        | (1,123)                       | (1,123) |
| At 31 December                                     | 131      | 1,652                         | 1,783   |
| Accumulated amortisation and impairment            |          |                               |         |
| At 1 January                                       | 12       | 1,226                         | 1,238   |
| Transfers from fellow subsidiaries                 | —        | 229                           | 229     |
| Disposals and write-off of fully amortised assets  | —        | (1,123)                       | (1,123) |
| Charge for the year                                | —        | 385                           | 385     |
| Write down of goodwill and other intangible assets | 18       | 3                             | 21      |
| At 31 December                                     | 30       | 720                           | 750     |
| Net book value at 31 December                      | 101      | 932                           | 1,033   |
| 2011                                               |          |                               |         |
| Cost                                               |          |                               |         |
| At 1 January                                       | 41       | 1,471                         | 1,512   |
| Transfers from subsidiaries                        | 85       | —                             | 85      |
| Transfers to subsidiaries                          | —        | (91)                          | (91)    |
| Additions                                          | —        | 625                           | 625     |
| Disposals and write-off of fully amortised assets  | —        | (17)                          | (17)    |
| At 31 December                                     | 126      | 1,988                         | 2,114   |
| Accumulated amortisation and impairment            |          |                               |         |
| At 1 January                                       | 12       | 1,057                         | 1,069   |
| Transfers to subsidiaries                          | —        | (35)                          | (35)    |
| Disposals and write-off of fully amortised assets  | —        | (18)                          | (18)    |
| Charge for the year                                | —        | 222                           | 222     |
| At 31 December                                     | 12       | 1,226                         | 1,238   |
| Net book value at 31 December                      | 114      | 762                           | 876     |

## Notes on the accounts

### 18 Intangible assets continued

The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash-generating unit (CGU) to which goodwill has been allocated with its carrying value.

Impairment testing involves the comparison of the carrying value of a CGU or group of CGUs with its recoverable amount. Recoverable amount is the higher of fair value and value in use. Value in use is the present value of expected future cash flows from the CGU or group of CGUs. Fair value is the price that would be received to sell an asset in an orderly transaction between market participants.

Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of CGUs; and the valuation of the separable assets of each business whose goodwill is being reviewed. Sensitivity to the more significant variables in each assessment are presented in the tables below.

The recoverable amounts for all CGUs at 30 September 2013 were based on the value in use test, using management's latest five-year forecasts. The long-term growth rates have been based on respective country nominal GDP growth rates. The risk discount rates are based on observable market long-term government bond yields and average industry betas adjusted for an appropriate risk premium.

In the light of downward revisions to its forecast financial performance, goodwill attributable to International Banking (IB) was tested for impairment as at 31 December 2013: recoverable amount was its value in use and the discount rate used in the calculation of value in use was 9.5% (30 September 2012 - 12.2%). The results showed IB goodwill in its entirety was to be impaired and an impairment loss of £208 million has been recognised in profit or loss.

The Group will accelerate the divestment of RBS Citizens Financial Group, the Group's US banking subsidiary. A partial initial public offering is now planned for 2014 and the Group intends to fully divest the business by the end of 2016. Notwithstanding this planned course of action, the recoverable amount of the US Retail & Commercial CGU remains its value in use.

The results of the annual impairment test for 2011 are presented using the Group's 2011 reportable segments which differ as a result of the changes to the Group's structure implemented during 2012. The change in reportable segments in 2012 did not impact the impairment tests performed in 2011.

The analysis of goodwill by operating segment is shown in Note 38.

The carrying value of goodwill and amount by which it is exceeded by the recoverable amount is set out below by division along with the key assumptions applied in calculating the recoverable amount and sensitivities to changes in those assumptions.

|                        | Goodwill<br>£bn | Assumptions                  |                               | Recoverable<br>amount exceeded<br>carrying value<br>£bn | Consequential impact of 1%<br>adverse movement in |                                | Consequential<br>impact of 5%<br>adverse movement<br>in forecast<br>pre-tax earnings<br>£bn |
|------------------------|-----------------|------------------------------|-------------------------------|---------------------------------------------------------|---------------------------------------------------|--------------------------------|---------------------------------------------------------------------------------------------|
|                        |                 | Terminal<br>growth rate<br>% | Pre-tax<br>discount rate<br>% |                                                         | Discount<br>rate<br>£bn                           | Terminal<br>growth rate<br>£bn |                                                                                             |
| September 2013         |                 |                              |                               |                                                         |                                                   |                                |                                                                                             |
| UK Retail              | 2.8             | 4.4                          | 10.4                          | 20.4                                                    | (4.2)                                             | (3.3)                          | (1.7)                                                                                       |
| UK Corporate           | 2.8             | 4.4                          | 10.5                          | 7.3                                                     | (3.3)                                             | (2.1)                          | (1.6)                                                                                       |
| Wealth                 | 0.6             | 4.4                          | 12.0                          | 0.7                                                     | (0.4)                                             | (0.3)                          | (0.2)                                                                                       |
| US Retail & Commercial | 3.8             | 4.8                          | 12.8                          | 4.1                                                     | (1.5)                                             | (0.8)                          | (0.8)                                                                                       |

|                        |     |     |      |      |       |       |       |
|------------------------|-----|-----|------|------|-------|-------|-------|
| September 2012         |     |     |      |      |       |       |       |
| UK Retail              | 2.8 | 4.7 | 13.5 | 13.8 | (2.5) | (2.4) | (1.3) |
| UK Corporate           | 2.8 | 4.7 | 13.5 | 6.3  | (2.3) | (1.8) | (1.4) |
| Wealth                 | 0.6 | 4.7 | 14.8 | 1.9  | (0.5) | (0.4) | (0.3) |
| International Banking  | 0.2 | 4.7 | 12.2 | 0.3  | (1.1) | (1.2) | (0.6) |
| US Retail & Commercial | 3.8 | 5.3 | 16.9 | 2.0  | (1.2) | (0.8) | (0.7) |

|                             |     |     |      |     |       |       |       |
|-----------------------------|-----|-----|------|-----|-------|-------|-------|
| September 2011              |     |     |      |     |       |       |       |
| UK Retail                   | 2.7 | 3.0 | 14.0 | 5.5 | (1.1) | (0.6) | (0.8) |
| UK Corporate                | 2.7 | 3.0 | 14.1 | 2.1 | (1.1) | (0.5) | (0.8) |
| Wealth                      | 0.6 | 3.0 | 11.0 | 3.9 | (1.0) | (0.7) | (0.4) |
| Global Transaction Services | 1.5 | 3.0 | 11.4 | 4.7 | (1.8) | (0.9) | (0.6) |
| US Retail & Commercial      | 2.8 | 5.0 | 14.4 | 0.2 | (1.1) | (0.5) | (0.6) |



## Notes on the accounts

### 19 Property, plant and equipment

|                                                              | Group                          |                            |                                     |                                      |                                           |                                    | Total<br>£m |
|--------------------------------------------------------------|--------------------------------|----------------------------|-------------------------------------|--------------------------------------|-------------------------------------------|------------------------------------|-------------|
|                                                              | Investment<br>properties<br>£m | Freehold<br>premises<br>£m | Long<br>leasehold<br>premises<br>£m | Short<br>leasehold<br>premises<br>£m | Computers<br>and other<br>equipment<br>£m | Operating<br>lease<br>assets<br>£m |             |
| <b>2013</b>                                                  |                                |                            |                                     |                                      |                                           |                                    |             |
| <i>Cost or valuation</i>                                     |                                |                            |                                     |                                      |                                           |                                    |             |
| At 1 January                                                 | 3,111                          | 2,952                      | 240                                 | 1,670                                | 4,341                                     | 3,324                              | 15,638      |
| Transfers to disposal groups                                 | —                              | (30)                       | —                                   | (12)                                 | (22)                                      | —                                  | (64)        |
| Transfers from fellow subsidiaries                           | 3                              | 8                          | —                                   | 14                                   | 41                                        | —                                  | 66          |
| Currency translation and other adjustments                   | 31                             | (9)                        | 3                                   | (9)                                  | (49)                                      | —                                  | (33)        |
| Reclassifications                                            | —                              | 6                          | (2)                                 | 4                                    | (8)                                       | —                                  | —           |
| Additions                                                    | 95                             | 49                         | 9                                   | 100                                  | 382                                       | 60                                 | 695         |
| Expenditure on investment properties                         | 13                             | —                          | —                                   | —                                    | —                                         | —                                  | 13          |
| Change in fair value of investment properties                | (281)                          | —                          | —                                   | —                                    | —                                         | —                                  | (281)       |
| Disposals and write-off of fully depreciated assets          | (339)                          | (34)                       | (10)                                | (58)                                 | (493)                                     | (1,485)                            | (2,419)     |
| At 31 December                                               | 2,633                          | 2,942                      | 240                                 | 1,709                                | 4,192                                     | 1,899                              | 13,615      |
| <i>Accumulated impairment, depreciation and amortisation</i> |                                |                            |                                     |                                      |                                           |                                    |             |
| At 1 January                                                 | —                              | 830                        | 127                                 | 879                                  | 2,975                                     | 1,123                              | 5,934       |
| Transfers to disposal groups                                 | —                              | (6)                        | —                                   | (9)                                  | (16)                                      | —                                  | (31)        |
| Transfers from fellow subsidiaries                           | —                              | 3                          | —                                   | 10                                   | 25                                        | —                                  | 38          |
| Currency translation and other adjustments                   | —                              | 2                          | 3                                   | (6)                                  | (22)                                      | (5)                                | (28)        |
| Disposals and write-off of fully depreciated assets          | —                              | (12)                       | (6)                                 | (46)                                 | (399)                                     | (559)                              | (1,022)     |
| Charge for the year                                          | —                              | 110                        | 10                                  | 133                                  | 376                                       | 211                                | 840         |
| Write down of property, plant and equipment                  | —                              | 15                         | 3                                   | —                                    | —                                         | —                                  | 18          |
| At 31 December                                               | —                              | 942                        | 137                                 | 961                                  | 2,939                                     | 770                                | 5,749       |
| Net book value at 31 December                                | 2,633                          | 2,000                      | 103                                 | 748                                  | 1,253                                     | 1,129                              | 7,866       |
| <b>2012</b>                                                  |                                |                            |                                     |                                      |                                           |                                    |             |
| <i>Cost or valuation</i>                                     |                                |                            |                                     |                                      |                                           |                                    |             |
| At 1 January                                                 | 4,413                          | 2,690                      | 192                                 | 1,708                                | 4,114                                     | 3,892                              | 17,009      |
| Transfers from disposal groups                               | —                              | 107                        | 12                                  | 93                                   | 41                                        | —                                  | 253         |
| Transfers from fellow subsidiaries                           | 48                             | 12                         | 35                                  | 39                                   | 58                                        | —                                  | 192         |
| Currency translation and other adjustments                   | (49)                           | (29)                       | (2)                                 | (21)                                 | (57)                                      | (54)                               | (212)       |
| Reclassifications                                            | 24                             | (22)                       | (4)                                 | (6)                                  | 8                                         | —                                  | —           |
| Additions                                                    | 238                            | 226                        | 8                                   | 111                                  | 453                                       | 402                                | 1,438       |
| Expenditure on investment properties                         | 10                             | —                          | —                                   | —                                    | —                                         | —                                  | 10          |
| Change in fair value of investment properties                | (148)                          | —                          | —                                   | —                                    | —                                         | —                                  | (148)       |
| Disposals and write-off of fully depreciated assets          | (1,425)                        | (32)                       | (1)                                 | (254)                                | (276)                                     | (916)                              | (2,904)     |
| At 31 December                                               | 3,111                          | 2,952                      | 240                                 | 1,670                                | 4,341                                     | 3,324                              | 15,638      |
| <i>Accumulated impairment, depreciation and amortisation</i> |                                |                            |                                     |                                      |                                           |                                    |             |
| At 1 January                                                 | —                              | 697                        | 93                                  | 775                                  | 2,779                                     | 1,187                              | 5,531       |
| Transfers from disposal groups                               | —                              | 43                         | 6                                   | 66                                   | 26                                        | —                                  | 141         |
| Transfers from fellow subsidiaries                           | —                              | 1                          | 16                                  | 15                                   | 85                                        | —                                  | 117         |
| Currency translation and other adjustments                   | —                              | (4)                        | —                                   | (11)                                 | (50)                                      | (21)                               | (86)        |
| Disposals and write-off of fully depreciated assets          | —                              | (12)                       | —                                   | (96)                                 | (263)                                     | (462)                              | (833)       |
| Charge for the year                                          | —                              | 94                         | 10                                  | 131                                  | 412                                       | 417                                | 1,064       |
| Write down of property, plant and equipment                  | —                              | 9                          | 1                                   | —                                    | —                                         | —                                  | 10          |
| At 31 December                                               | —                              | 828                        | 126                                 | 880                                  | 2,989                                     | 1,121                              | 5,944       |
| Net book value at 31 December                                | 3,111                          | 2,124                      | 114                                 | 790                                  | 1,352                                     | 2,203                              | 9,694       |

## Notes on the accounts

### 19 Property, plant and equipment continued

|                                                              | Group                          |                            |                                     |                                      |                                           |                                    |               |
|--------------------------------------------------------------|--------------------------------|----------------------------|-------------------------------------|--------------------------------------|-------------------------------------------|------------------------------------|---------------|
|                                                              | Investment<br>properties<br>£m | Freehold<br>premises<br>£m | Long<br>leasehold<br>premises<br>£m | Short<br>leasehold<br>premises<br>£m | Computers<br>and other<br>equipment<br>£m | Operating<br>lease<br>assets<br>£m | Total<br>£m   |
| 2011                                                         |                                |                            |                                     |                                      |                                           |                                    |               |
| <b>Cost or valuation</b>                                     |                                |                            |                                     |                                      |                                           |                                    |               |
| At 1 January                                                 | 4,170                          | 2,768                      | 215                                 | 1,682                                | 3,897                                     | 9,235                              | 21,967        |
| Transfers to disposal groups                                 | —                              | (107)                      | (12)                                | (93)                                 | (49)                                      | (5,355)                            | (5,616)       |
| Currency translation and other adjustments                   | (101)                          | 7                          | (2)                                 | (4)                                  | (59)                                      | 3                                  | (156)         |
| Reclassifications                                            | —                              | (8)                        | (20)                                | 22                                   | 6                                         | —                                  | —             |
| Additions                                                    | 1,262                          | 67                         | 17                                  | 149                                  | 477                                       | 1,384                              | 3,356         |
| Expenditure on investment properties                         | 14                             | —                          | —                                   | —                                    | —                                         | —                                  | 14            |
| Change in fair value of investment properties                | (139)                          | —                          | —                                   | —                                    | —                                         | —                                  | (139)         |
| Disposals and write-off of fully depreciated assets          | (793)                          | (37)                       | (6)                                 | (48)                                 | (158)                                     | (1,375)                            | (2,417)       |
| <b>At 31 December</b>                                        | <b>4,413</b>                   | <b>2,690</b>               | <b>192</b>                          | <b>1,708</b>                         | <b>4,114</b>                              | <b>3,892</b>                       | <b>17,009</b> |
| <b>Accumulated impairment, depreciation and amortisation</b> |                                |                            |                                     |                                      |                                           |                                    |               |
| At 1 January                                                 | —                              | 664                        | 102                                 | 729                                  | 2,480                                     | 1,849                              | 5,824         |
| Transfers to disposal groups                                 | —                              | (43)                       | (6)                                 | (66)                                 | (26)                                      | (730)                              | (871)         |
| Currency translation and other adjustments                   | —                              | 7                          | —                                   | 2                                    | (9)                                       | 15                                 | 15            |
| Reclassifications                                            | —                              | 1                          | (7)                                 | 7                                    | —                                         | (1)                                | —             |
| Disposals and write-off of fully depreciated assets          | —                              | (26)                       | —                                   | (32)                                 | (110)                                     | (466)                              | (634)         |
| Charge for the year                                          | —                              | 94                         | 4                                   | 135                                  | 444                                       | 520                                | 1,197         |
| <b>At 31 December</b>                                        | <b>—</b>                       | <b>697</b>                 | <b>93</b>                           | <b>775</b>                           | <b>2,779</b>                              | <b>1,187</b>                       | <b>5,531</b>  |
| <b>Net book value at 31 December</b>                         | <b>4,413</b>                   | <b>1,993</b>               | <b>99</b>                           | <b>933</b>                           | <b>1,335</b>                              | <b>2,705</b>                       | <b>11,478</b> |

Investment property valuations principally employ present value techniques that discount expected cash flows. Expected cash flows reflect rental income, occupancy and residual market values; valuations are sensitive to changes in these factors. The fair value measurement of non-specialised properties in locations where the market for such properties is active and transparent are categorised as level 2 (46%); otherwise investment property fair value measurements are categorised as level 3 (54%).

Valuations were carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body; property with a fair value of £985 million was valued by independent valuers.

The fair value of investment properties includes £271 million of depreciation since purchase (2012 - £186 million; 2011 - £146 million).

Rental income from investment properties was £244 million (2012 - £267 million; 2011 - £270 million). Direct operating expenses of investment properties were £91 million (2012 - £125 million; 2011 - £110 million).

Property, plant and equipment, excluding investment properties, include £42 million (2012 - £35 million; 2011 - £186 million) assets in the course of construction.

## Notes on the accounts

### 19 Property, plant and equipment continued

|                                                              | Bank                       |                                     |                                      |                                           |             |
|--------------------------------------------------------------|----------------------------|-------------------------------------|--------------------------------------|-------------------------------------------|-------------|
|                                                              | Freehold<br>premises<br>£m | Long<br>leasehold<br>premises<br>£m | Short<br>leasehold<br>premises<br>£m | Computers<br>and other<br>equipment<br>£m | Total<br>£m |
| <b>2013</b>                                                  |                            |                                     |                                      |                                           |             |
| <i>Cost or valuation</i>                                     |                            |                                     |                                      |                                           |             |
| At 1 January                                                 | 1,297                      | 91                                  | 687                                  | 2,712                                     | 4,787       |
| Transfers from fellow subsidiaries                           | —                          | —                                   | 8                                    | 13                                        | 21          |
| Currency translation and other adjustments                   | 1                          | 2                                   | (3)                                  | (3)                                       | (3)         |
| Reclassifications                                            | (3)                        | —                                   | 5                                    | (2)                                       | —           |
| Additions                                                    | 10                         | 3                                   | 55                                   | 258                                       | 326         |
| Disposals and write-off of fully depreciated assets          | (2)                        | —                                   | (29)                                 | (314)                                     | (345)       |
| At 31 December                                               | 1,303                      | 96                                  | 723                                  | 2,664                                     | 4,786       |
| <i>Accumulated impairment, depreciation and amortisation</i> |                            |                                     |                                      |                                           |             |
| At 1 January                                                 | 303                        | 49                                  | 296                                  | 1,709                                     | 2,357       |
| Transfers from fellow subsidiaries                           | —                          | —                                   | 4                                    | 8                                         | 12          |
| Currency translation and other adjustments                   | 6                          | 4                                   | (1)                                  | (1)                                       | 8           |
| Write-down of property, plant and equipment                  | 2                          | —                                   | —                                    | —                                         | 2           |
| Disposals and write-off of fully depreciated assets          | (2)                        | —                                   | (20)                                 | (237)                                     | (259)       |
| Charge for the year                                          | 52                         | 5                                   | 56                                   | 269                                       | 382         |
| At 31 December                                               | 361                        | 58                                  | 335                                  | 1,748                                     | 2,502       |
| Net book value at 31 December                                | 942                        | 38                                  | 388                                  | 916                                       | 2,284       |
| <b>2012</b>                                                  |                            |                                     |                                      |                                           |             |
| <i>Cost or valuation</i>                                     |                            |                                     |                                      |                                           |             |
| At 1 January                                                 | 1,018                      | 48                                  | 708                                  | 2,409                                     | 4,183       |
| Transfers from disposal groups                               | 80                         | 9                                   | 90                                   | 40                                        | 219         |
| Transfers from fellow subsidiaries                           | 7                          | 35                                  | 35                                   | 52                                        | 129         |
| Currency translation and other adjustments                   | (1)                        | —                                   | (2)                                  | —                                         | (3)         |
| Reclassifications                                            | 2                          | (4)                                 | (2)                                  | 4                                         | —           |
| Additions                                                    | 195                        | 3                                   | 53                                   | 329                                       | 580         |
| Disposals and write-off of fully depreciated assets          | (4)                        | —                                   | (195)                                | (122)                                     | (321)       |
| At 31 December                                               | 1,297                      | 91                                  | 687                                  | 2,712                                     | 4,787       |
| <i>Accumulated impairment, depreciation and amortisation</i> |                            |                                     |                                      |                                           |             |
| At 1 January                                                 | 232                        | 24                                  | 232                                  | 1,451                                     | 1,939       |
| Transfers from disposal groups                               | 33                         | 4                                   | 63                                   | 23                                        | 123         |
| Transfers from fellow subsidiaries                           | —                          | 16                                  | 13                                   | 81                                        | 110         |
| Currency translation and other adjustments                   | —                          | —                                   | —                                    | (3)                                       | (3)         |
| Disposals and write-off of fully depreciated assets          | (2)                        | —                                   | (64)                                 | (124)                                     | (190)       |
| Charge for the year                                          | 40                         | 5                                   | 52                                   | 281                                       | 378         |
| At 31 December                                               | 303                        | 49                                  | 296                                  | 1,709                                     | 2,357       |
| Net book value at 31 December                                | 994                        | 42                                  | 391                                  | 1,003                                     | 2,430       |

## Notes on the accounts

### 19 Property, plant and equipment continued

|                                                       | Bank                       |                                     |                                      |                                           | Total<br>£m |
|-------------------------------------------------------|----------------------------|-------------------------------------|--------------------------------------|-------------------------------------------|-------------|
|                                                       | Freehold<br>premises<br>£m | Long<br>leasehold<br>premises<br>£m | Short<br>leasehold<br>premises<br>£m | Computers<br>and other<br>equipment<br>£m |             |
| 2011                                                  |                            |                                     |                                      |                                           |             |
| Cost or valuation                                     |                            |                                     |                                      |                                           |             |
| At 1 January                                          | 1,093                      | 54                                  | 754                                  | 2,177                                     | 4,078       |
| Currency translation and other adjustments            | (80)                       | (9)                                 | (90)                                 | (40)                                      | (219)       |
| Reclassifications                                     | 1                          | —                                   | (2)                                  | 1                                         | —           |
| Additions                                             | 7                          | 3                                   | 71                                   | 398                                       | 479         |
| Disposals and write-off of fully depreciated assets   | (3)                        | —                                   | (25)                                 | (127)                                     | (155)       |
| At 31 December                                        | 1,018                      | 48                                  | 708                                  | 2,409                                     | 4,183       |
| Accumulated impairment, depreciation and amortisation |                            |                                     |                                      |                                           |             |
| At 1 January                                          | 226                        | 27                                  | 254                                  | 1,270                                     | 1,777       |
| Currency translation and other adjustments            | (33)                       | (4)                                 | (63)                                 | (23)                                      | (123)       |
| Transfer from fellow subsidiary                       | (2)                        | 1                                   | —                                    | 1                                         | —           |
| Disposals and write-off of fully depreciated assets   | —                          | (2)                                 | (13)                                 | (91)                                      | (106)       |
| Charge for the year                                   | 41                         | 2                                   | 54                                   | 294                                       | 391         |
| At 31 December                                        | 232                        | 24                                  | 232                                  | 1,451                                     | 1,939       |
| Net book value at 31 December                         | 786                        | 24                                  | 476                                  | 958                                       | 2,244       |

### 20 Prepayments, accrued income and other assets

|                                             | Group      |            |            | Bank       |            |            |
|---------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                             | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Prepayments                                 | 608        | 862        | 939        | 366        | 2,093      | 2,087      |
| Accrued income                              | 475        | 463        | 567        | 254        | 242        | 325        |
| Deferred expenses                           | 39         | 66         | 77         | 14         | 20         | 430        |
| Pension schemes in net surplus (see Note 4) | 214        | 144        | 24         | 119        | 99         | 8          |
| Interests in associates                     | 223        | 317        | 292        | 67         | 185        | 228        |
| Other assets                                | 4,345      | 4,252      | 3,993      | 2,426      | 1,794      | 2,260      |
|                                             | 5,904      | 6,104      | 5,892      | 3,246      | 4,433      | 5,338      |

## Notes on the accounts

### 21 Assets and liabilities of disposal groups

|                                       | Group        |            |               | Bank       |            |               |
|---------------------------------------|--------------|------------|---------------|------------|------------|---------------|
|                                       | 2013<br>£m   | 2012<br>£m | 2011<br>£m    | 2013<br>£m | 2012<br>£m | 2011<br>£m    |
| <b>Assets of disposal groups</b>      |              |            |               |            |            |               |
| Cash and balances at central banks    | —            | —          | 100           | —          | —          | 94            |
| Loans and advances to banks           | 15           | 20         | 25            | —          | —          | 1             |
| Loans and advances to customers       | 689          | 263        | 18,723        | —          | —          | 18,110        |
| Debt securities and equity shares     | —            | 5          | 5             | —          | —          | —             |
| Derivatives                           | 1            | 3          | 439           | —          | —          | 414           |
| Settlement balances                   | —            | —          | 14            | —          | —          | —             |
| Intangible assets                     | —            | —          | 15            | —          | —          | —             |
| Property, plant and equipment         | 32           | —          | 4,749         | —          | —          | 96            |
| Other assets                          | 53           | 13         | 18            | —          | —          | —             |
|                                       | <b>790</b>   | <b>304</b> | <b>24,088</b> | <b>—</b>   | <b>—</b>   | <b>18,715</b> |
| <b>Liabilities of disposal groups</b> |              |            |               |            |            |               |
| Customer accounts                     | 3,190        | 18         | 21,820        | —          | —          | 20,390        |
| Derivatives                           | 1            | 3          | 126           | —          | —          | 88            |
| Settlement balances                   | —            | —          | 8             | —          | —          | —             |
| Other liabilities                     | 19           | 114        | 886           | —          | —          | —             |
|                                       | <b>3,210</b> | <b>135</b> | <b>22,840</b> | <b>—</b>   | <b>—</b>   | <b>20,478</b> |

Disposal groups at 31 December 2013 primarily comprise the Chicago area retail branches, small business operations and select middle market relationships in the Chicago market which form part of RBS Citizens Financial Group.

At 31 December 2011, disposal groups comprised the RBS Aviation Capital business which was sold in the second half of 2012 and the RBS England and Wales and NatWest Scotland branch-based businesses, along with certain SME and corporate activities across the UK ('UK branch-based businesses'). Following Santander's withdrawal from the proposed sale in October 2012, the Group concluded that a sale within 12 months was no longer highly probable; accordingly at 31 December 2012 the assets and liabilities of this UK branch-based business ceased to be classified as a disposal group.

No adjustment was required to the carrying value of these assets and liabilities on reclassification. In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', comparatives have not been restated.

In 2011, £80 million of allocated goodwill was written off against operating expenses in respect of the UK branch-based businesses. No adjustment was made in respect of the RBS Aviation Capital business.

### 22 Short positions

|                        | Group         |               |               | Bank          |               |               |
|------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                        | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    |
| <b>Debt securities</b> |               |               |               |               |               |               |
| - Government           | 24,661        | 23,529        | 32,812        | 15,838        | 11,984        | 19,910        |
| - Other issuers        | 3,087         | 3,411         | 5,972         | 1,807         | 1,489         | 3,288         |
| <b>Equity shares</b>   | <b>256</b>    | <b>601</b>    | <b>1,662</b>  | <b>253</b>    | <b>601</b>    | <b>1,660</b>  |
|                        | <b>28,004</b> | <b>27,541</b> | <b>40,446</b> | <b>17,898</b> | <b>14,074</b> | <b>24,858</b> |

Note:

(1) All short positions are classified as held-for-trading.

## Notes on the accounts

### 23 Accruals, deferred income and other liabilities

|                                                           | Group      |            |            | Bank       |            |            |
|-----------------------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                                           | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Notes in circulation                                      | 1,759      | 1,684      | 1,683      | 1,124      | 1,106      | 1,130      |
| Current tax                                               | 510        | 323        | 209        | 492        | 526        | 525        |
| Accruals                                                  | 2,860      | 3,276      | 4,040      | 1,803      | 2,019      | 2,484      |
| Deferred income                                           | 515        | 718        | 872        | 326        | 505        | 537        |
| Provisions for liabilities and charges (see tables below) | 5,420      | 3,061      | 1,310      | 1,721      | 1,895      | 652        |
| Other liabilities (1)                                     | 3,689      | 2,965      | 6,695      | 1,735      | 1,304      | 3,512      |
|                                                           | 14,753     | 12,027     | 14,809     | 7,201      | 7,355      | 8,840      |

Note:

(1) Other liabilities include £25 million (2012 - £24 million; 2011 - £15 million) in respect of share-based compensation.

|                                               | Group                                        |                                                |                                        |                 |                                             |                      |                                             |                    | Total<br>£m |
|-----------------------------------------------|----------------------------------------------|------------------------------------------------|----------------------------------------|-----------------|---------------------------------------------|----------------------|---------------------------------------------|--------------------|-------------|
|                                               | Payment<br>Protection<br>Insurance (1)<br>£m | Interest Rate<br>Hedging<br>Products (2)<br>£m | Other<br>customer<br>redress (3)<br>£m | LIBOR (4)<br>£m | Other<br>regulatory<br>provisions (5)<br>£m | Litigation (6)<br>£m | Technology<br>incident<br>redress (7)<br>£m | Property (8)<br>£m |             |
| <b>Provisions for liabilities and charges</b> |                                              |                                                |                                        |                 |                                             |                      |                                             |                    |             |
| At 1 January 2013                             | 895                                          | 676                                            | 161                                    | 381             | 200                                         | 84                   | 28                                          | 391                | 3,061       |
| Transfer from accruals and other liabilities  | —                                            | —                                              | —                                      | 10              | 10                                          | —                    | —                                           | 21                 | 20          |
| Currency translation and other movements      | —                                            | —                                              | (3)                                    | (2)             | —                                           | (21)                 | —                                           | —                  | (22)        |
| Charge to income statement                    | 900                                          | 550                                            | 557                                    | 315             | 124                                         | 2,019                | —                                           | 153                | 4,754       |
| Releases to income statement                  | —                                            | —                                              | (105)                                  | —               | (123)                                       | (25)                 | —                                           | (91)               | (347)       |
| Provisions utilised                           | (869)                                        | (149)                                          | (274)                                  | (288)           | (61)                                        | (94)                 | (28)                                        | (95)               | (2,046)     |
| At 31 December 2013                           | 926                                          | 1,077                                          | 336                                    | 416             | 150                                         | 1,963                | —                                           | 379                | 5,420       |

|                                               | Bank                                         |                                                |                                        |                 |                                             |                      |                                             |                    | Total<br>£m |
|-----------------------------------------------|----------------------------------------------|------------------------------------------------|----------------------------------------|-----------------|---------------------------------------------|----------------------|---------------------------------------------|--------------------|-------------|
|                                               | Payment<br>Protection<br>Insurance (1)<br>£m | Interest Rate<br>Hedging<br>Products (2)<br>£m | Other<br>customer<br>redress (3)<br>£m | LIBOR (4)<br>£m | Other<br>regulatory<br>provisions (5)<br>£m | Litigation (6)<br>£m | Technology<br>incident<br>redress (7)<br>£m | Property (8)<br>£m |             |
| <b>Provisions for liabilities and charges</b> |                                              |                                                |                                        |                 |                                             |                      |                                             |                    |             |
| At 1 January 2013                             | 390                                          | 265                                            | 135                                    | 381             | 200                                         | 28                   | 9                                           | 252                | 1,895       |
| Transfer from accruals and other liabilities  | —                                            | —                                              | —                                      | 10              | 10                                          | —                    | —                                           | 21                 | 20          |
| Currency translation and other movements      | —                                            | —                                              | —                                      | (2)             | —                                           | (1)                  | —                                           | (1)                | (4)         |
| Charge to income statement                    | 366                                          | 201                                            | 51                                     | 315             | —                                           | 34                   | —                                           | 120                | 1,189       |
| Releases to income statement                  | —                                            | —                                              | (103)                                  | —               | (88)                                        | (2)                  | —                                           | (83)               | (276)       |
| Provisions utilised                           | (387)                                        | (71)                                           | (25)                                   | (288)           | (61)                                        | (19)                 | (9)                                         | (69)               | (1,103)     |
| At 31 December 2013                           | 369                                          | 395                                            | 58                                     | 416             | 61                                          | 40                   | —                                           | 240                | 1,721       |

Notes:

(1) The principal assumptions underlying the Group's provision in respect of PPI sales are: assessment of the total number of complaints that the Group will receive; the proportion of these that will result in redress; and the average cost of such redress. The number of complaints has been estimated from an analysis of the Group's portfolio of PPI policies sold by vintage and by product. Estimates of the percentage of policyholders that will lodge complaints (the take up rate) and of the number of these that will be upheld (the uphold rate) have been established based on recent experience, guidance in the FSA policy statements and expected rate of responses from proactive customer contact. The average redress assumption is based on recent experience and the calculation rules in the FSA statement.

The table below shows the sensitivity of the provision to changes in the principal assumptions (all other assumptions remaining the same).

| Assumption      | Actual date | Current<br>assumptions | Sensitivity                  |                                               |
|-----------------|-------------|------------------------|------------------------------|-----------------------------------------------|
|                 |             |                        | Change in<br>assumption<br>% | Consequential<br>change in<br>provision<br>£m |
| Take up rate    | 36%         | 38%                    | +/-5                         | +/-45                                         |
| Uphold rate (1) | 84%         | 83%                    | +/-5                         | +/-30                                         |
| Average redress | £1,733      | £1,646                 | +/-5                         | +/-26                                         |

Note:

(1) Uphold rates exclude claims where no PPI policy was held.

## Notes on the accounts

### 23 Accruals, deferred income and other liabilities continued

Notes continued:

Interest that will be payable on successful complaints has been included in the provision as has the estimated cost to the Group of administering the redress process. The Group expects the majority of the cash outflows associated with this provision to have occurred by the end of 2014. There are uncertainties as to the eventual cost of redress which will depend on actual complaint volumes, take up and uphold rates and average redress costs.

Background information in relation to PPI claims is given in Note 31.

- (2) The Group has estimated £1,250 million for its liability in respect of the sale of Interest Rate Hedging Products based on experience, having now agreed a substantial number of outcomes with the independent skilled person appointed to review all decisions. The provision includes redress that will be paid to customers, interest payable on customer redress, the cost to the Group of exiting the hedging positions and the cost of undertaking the review. It does not include provision for any consequential losses that customers may have suffered as the Group is unable to reliably measure any liability it may have for such losses.

The principal assumptions underlying the Group's provision are:

- the proportion of relevant customers that will not opt in to the review
- the number of transactions that qualify for redress
- the nature of the redress (in particular whether a product is terminated or replaced with an alternative product and/or a different profile)
- the cost of the review

| Assumption                                                          | Sensitivity            |                                      |
|---------------------------------------------------------------------|------------------------|--------------------------------------|
|                                                                     | Change in assumption % | Consequential change in provision £m |
| Proportion of relevant customers that will not opt in to the review | +/-5                   | +/-47                                |
| Proportion of customer transactions qualifying for redress          | +/-5                   | +/-71                                |
| Average redress                                                     | +/-5                   | +/-71                                |

Uncertainties remain over the number of transactions that will qualify for redress and the nature and cost of that redress.

Background information in relation to Interest Rate Hedging Products claims is given in Note 31.

- (3) The Group has provided for customer redress in relation to certain other retail products. None of these provisions is individually material.
- (4) On 6 February 2013, the Group reached agreement with the FSA, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million and a provision for this amount was recognised in 2012. The Group continues to cooperate with other governmental and regulatory authorities and, as a result of progress on these matters in 2013, the provision was increased by £315 million. For further details see Note 31.
- (5) The Group is subject to a number of investigations by regulatory and other authorities. Details of these investigations and a discussion of the nature of the associated uncertainties are given in Note 31.
- (6) Arising out of its normal business operations, the Group is party to legal proceedings in the United Kingdom, the United States and other jurisdictions. Litigation provisions at 31 December 2012 related to a number of proceedings; no individual provision was material. An additional charge of £2,019 million was recorded in 2013 as a result of greater levels of certainty on expected outcomes, primarily in respect of matters relating to mortgage-backed securities and securities-related litigation following third party litigation settlements and regulatory decisions. Detailed descriptions of the Group's legal proceedings and discussion of the associated uncertainties are given in Note 31.
- (7) In June 2012, the Group experienced a technology incident that affected its transaction batch processing. Provisions of £175 million were charged during 2012 to meet the waiver of fees and interest; redress for customers of the Group; and other costs principally staff costs. These costs have been now been settled.
- (8) The property provisions principally comprise provisions for onerous lease contracts. Provision is made for future rentals payable in respect of vacant leasehold property and for any shortfall where leased property is sub-let at a rental lower than the lease rentals payable by the Group.

## Notes on the accounts

### 24 Deferred tax

|                        | Group      |            |            | Bank       |            |            |
|------------------------|------------|------------|------------|------------|------------|------------|
|                        | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Deferred tax liability | 189        | 789        | 1,384      | —          | —          | —          |
| Deferred tax asset     | (3,435)    | (3,066)    | (3,320)    | (2,298)    | (2,878)    | (2,584)    |
| Net deferred tax asset | (3,246)    | (2,277)    | (1,936)    | (2,298)    | (2,878)    | (2,584)    |

Net deferred tax asset comprised:

|                                                  | Group         |                                            |                  |                         |                          |                                                    |                                                     |                   |                               |                        |                                           |             | Total<br>£m |
|--------------------------------------------------|---------------|--------------------------------------------|------------------|-------------------------|--------------------------|----------------------------------------------------|-----------------------------------------------------|-------------------|-------------------------------|------------------------|-------------------------------------------|-------------|-------------|
|                                                  | Pension<br>£m | Accelerated<br>capital<br>allowances<br>£m | Provisions<br>£m | Deferred<br>gains<br>£m | IFRS<br>transition<br>£m | Fair<br>value of<br>financial<br>instruments<br>£m | Available-<br>for-sale<br>financial<br>assets<br>£m | Intangibles<br>£m | Cash<br>flow<br>hedging<br>£m | Share<br>schemes<br>£m | Tax<br>losses<br>carried<br>forward<br>£m | Other<br>£m |             |
| At 1 January 2012                                | (476)         | 2,363                                      | (1,285)          | 70                      | (218)                    | 75                                                 | 119                                                 | 177               | 235                           | (17)                   | (3,000)                                   | 21          | (1,936)     |
| Charge/(credit) to income statement              | 6             | (505)                                      | 219              | (12)                    | 77                       | (98)                                               | (28)                                                | 17                | 188                           | (1)                    | 283                                       | (67)        | 79          |
| (Credit)/charge to other<br>comprehensive income | (373)         | —                                          | —                | (10)                    | —                        | —                                                  | 36                                                  | —                 | 152                           | 5                      | (170)                                     | —           | (360)       |
| (Disposals)/acquisitions<br>of subsidiaries      | —             | (38)                                       | —                | —                       | —                        | (6)                                                | —                                                   | —                 | —                             | —                      | —                                         | 52          | 8           |
| Transfer to disposal groups                      | —             | —                                          | (85)             | —                       | —                        | —                                                  | —                                                   | —                 | —                             | —                      | —                                         | —           | (85)        |
| Currency translations<br>and other adjustments   | 20            | (37)                                       | 34               | 8                       | (7)                      | 7                                                  | 9                                                   | (8)               | —                             | —                      | 8                                         | (17)        | 17          |
| At 1 January 2013                                | (823)         | 1,783                                      | (1,117)          | 56                      | (148)                    | (22)                                               | 136                                                 | 186               | 575                           | (13)                   | (2,879)                                   | (11)        | (2,277)     |
| Charge/(credit) to income statement              | 54            | (481)                                      | (409)            | (13)                    | 61                       | 10                                                 | (27)                                                | 45                | 53                            | 1                      | 1,034                                     | (103)       | 225         |
| Charge/(credit) to other<br>comprehensive income | 245           | —                                          | (3)              | —                       | —                        | —                                                  | (127)                                               | —                 | (632)                         | (1)                    | (348)                                     | —           | (866)       |
| (Disposals)/acquisitions<br>of subsidiaries      | —             | (21)                                       | —                | —                       | —                        | —                                                  | —                                                   | 1                 | —                             | —                      | —                                         | —           | (20)        |
| Currency translations<br>and other adjustments   | (3)           | (20)                                       | 26               | —                       | —                        | —                                                  | 3                                                   | (7)               | 3                             | —                      | (303)                                     | (7)         | (308)       |
| At 31 December 2013                              | (527)         | 1,261                                      | (1,503)          | 43                      | (87)                     | (12)                                               | (15)                                                | 225               | (1)                           | (13)                   | (2,496)                                   | (121)       | (3,246)     |

|                                               | Bank          |                                            |                  |                         |                          |                            |                        |                                        |             |             |
|-----------------------------------------------|---------------|--------------------------------------------|------------------|-------------------------|--------------------------|----------------------------|------------------------|----------------------------------------|-------------|-------------|
|                                               | Pension<br>£m | Accelerated<br>capital<br>allowances<br>£m | Provisions<br>£m | Deferred<br>gains<br>£m | IFRS<br>transition<br>£m | Cash flow<br>hedging<br>£m | Share<br>schemes<br>£m | Tax losses<br>carried<br>forward<br>£m | Other<br>£m | Total<br>£m |
| At 1 January 2012                             | (4)           | (63)                                       | (253)            | 37                      | (92)                     | 440                        | (25)                   | (2,623)                                | (1)         | (2,584)     |
| Charge/(credit) to income statement           | 6             | (331)                                      | (46)             | (6)                     | 35                       | 4                          | —                      | 139                                    | 2           | (197)       |
| (Credit)/charge to other comprehensive income | (26)          | —                                          | —                | (6)                     | —                        | 93                         | (1)                    | (170)                                  | —           | (110)       |
| Currency translations and other adjustments   | 21            | —                                          | (5)              | 6                       | (7)                      | —                          | —                      | —                                      | (2)         | 13          |
| At 1 January 2013                             | (3)           | (394)                                      | (304)            | 31                      | (64)                     | 537                        | (26)                   | (2,654)                                | (1)         | (2,878)     |
| Charge/(credit) to income statement           | 20            | (96)                                       | 111              | (8)                     | 27                       | 3                          | 1                      | 1,608                                  | —           | 1,666       |
| (Credit)/charge to other comprehensive income | (6)           | —                                          | —                | —                       | —                        | (440)                      | —                      | (348)                                  | —           | (794)       |
| Currency translations and other adjustments   | —             | —                                          | 7                | —                       | —                        | —                          | —                      | (299)                                  | —           | (292)       |
| At 31 December 2013                           | 11            | (490)                                      | (186)            | 23                      | (37)                     | 100                        | (25)                   | (1,693)                                | (1)         | (2,298)     |



## Notes on the accounts

### 24 Deferred tax continued

Deferred tax assets in respect of unused tax losses are recognised if the losses can be used to offset probable future taxable profits after taking into account the expected reversal of other temporary differences. Recognised deferred tax assets in respect of tax losses are analysed below.

|                                      | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|--------------------------------------|------------|------------|------------|
| UK tax losses carried forward        |            |            |            |
| - The Royal Bank of Scotland plc     | 1,693      | 2,654      | 2,623      |
| - National Westminster Bank Plc      | 718        | 66         | 93         |
|                                      | 2,411      | 2,720      | 2,716      |
| Overseas tax losses carried forward  |            |            |            |
| - Ulster Bank Ireland                | 74         | 72         | 284        |
| - RBS Citizens Financial Group, Inc. | 11         | 87         | —          |
|                                      | 85         | 159        | 284        |
|                                      | 2,496      | 2,879      | 3,000      |

#### UK tax losses

Under UK tax rules, tax losses do not expire and can be carried forward indefinitely.

*The Royal Bank of Scotland plc* - the deferred tax asset in respect of tax losses brought forward at 1 January 2013 related mainly to trading losses that arose in the UK branch of RBS N.V. These were transferred following the transfer of the majority of the activities of the UK Branch of RBS N.V. to The Royal Bank of Scotland plc. The UK Branch tax losses attributable to credit market write-downs during the financial crisis were principally incurred between 2007 and 2009.

The Royal Bank of Scotland plc reported a taxable profit in 2011 and tax losses in 2012 and 2013. The taxable loss for 2012 reflected the reversal of previous own credit gains offset by core banking profitability. In 2013, core profitability remains strong; UK tax losses of £3 billion are attributable to loan impairment charges arising from the RCR accelerated recovery strategy recorded in the final quarter of the period and significant regulatory and conduct provisions. The additional restructuring costs anticipated by the latest strategic plan will constrain the utilisation of carried forward tax losses in the near-term. Consequently a reduction in the carrying value of deferred tax assets of £701 million has been recorded in 2013. In addition, deferred tax has not been recognised in respect of excess 2013 UK taxable losses of £750 million, representing an unprovided deferred tax asset of £150 million. The Group expects that the recognised deferred tax asset in respect of tax losses amounting to £8,465 million will be recovered within eight years. A 20% reduction in forecast profits would extend the recovery period by a year.

*National Westminster Bank Plc* - the deferred tax asset in respect of tax losses at 31 December 2013 relates to residual unrelieved trading losses that arose between 2009 and 2013. 60% of the losses that arose were relieved against taxable profits arising in other UK Group companies. Based on the RBS Group's strategic plan, the residual carried forward losses will be fully utilised against future taxable profits of the company by the end of 2018. A 20% reduction in forecast profits would extend the recovery period by one year.

#### Overseas tax losses

*Ulster Bank Ireland* - a deferred asset has been recognised in respect of £592 million of total tax losses of £11,575 million carried forward at 31 December 2013. These losses arose principally as a result of significant impairment charges reflecting deteriorating economic conditions in the Republic of Ireland. Impairment charges are expected to reduce in the future. Based on the RBS Group's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits of the company by the end of 2018. A 20% reduction in forecast profits would extend the recovery period by one year.

*RBS Citizens Financial Group* - a deferred asset of £11 million has been recognised in respect of total tax losses of £32 million carried forward at 31 December 2013. Based on the Group's strategic plan, the losses on which a deferred tax asset has been recognised will be utilised against future taxable profits in 2014. A 20% reduction in forecast profits would not extend the recovery period beyond 2014.

#### Unrecognised deferred tax

Deferred tax assets of £2,723 million (2012 - £1,295 million, 2011 - £743 million) have not been recognised in respect of tax losses carried forward of £19,145 million (2012 - £10,230 million, 2011 - £6,525 million) in jurisdictions where doubt exists over the availability of future taxable profits. Of these losses, £142 million expire within one year, £338 within five years and £2,308 million thereafter. The balance of tax losses carried forward has no time limit.

Deferred tax liabilities of £186 million (2012 - £214 million; 2011 - £249 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains. Changes to UK tax legislation largely exempts from UK tax, overseas dividends received on or after 1 July 2009.

## Notes on the accounts

### 25 Subordinated liabilities

|                      | Group      |            |            | Bank       |            |            |
|----------------------|------------|------------|------------|------------|------------|------------|
|                      | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Dated loan capital   | 20,566     | 21,442     | 20,931     | 19,132     | 20,383     | 19,815     |
| Undated loan capital | 9,422      | 9,118      | 7,959      | 8,576      | 8,267      | 7,079      |
| Preference shares    | 3,146      | 3,291      | 3,434      | 2,858      | 2,985      | 3,120      |
|                      | 33,134     | 33,851     | 32,324     | 30,566     | 31,635     | 30,014     |

In March 2012, the Group exchanged certain subordinated debt securities for new subordinated debt securities. The exchanges involving instruments classified as liabilities all met the criteria in IFRS for treatment as the extinguishment of the original liability and the recognition of a new financial liability.

The RBS Group has now resumed payments on all discretionary non-equity capital instruments following the end of the European Commission ban in 2012. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

Certain preference shares issued by the company are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 2006.

## Notes on the accounts

### 25 Subordinated liabilities continued

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

| 2013 - final redemption | Group      |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2014<br>£m | 2015<br>£m | 2016-2018<br>£m | 2019-2023<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 60         | 608        | 60              | 5,365           | —                | 4,825           | 10,918      |
| US dollar               | 729        | 621        | 1,064           | 4,442           | 210              | 5,848           | 12,914      |
| Euro                    | 194        | 657        | 2,953           | 1,717           | —                | 1,539           | 7,060       |
| Other                   | 395        | 617        | 119             | 813             | —                | 298             | 2,242       |
|                         | 1,378      | 2,503      | 4,196           | 12,337          | 210              | 12,510          | 33,134      |

| 2013 - call date | Group           |            |            |                 |                 |                  |                 | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                  | Currently<br>£m | 2014<br>£m | 2015<br>£m | 2016-2018<br>£m | 2019-2023<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling         | 1               | 119        | 695        | 1,791           | 5,518           | 43               | 2,751           | 10,918      |
| US dollar        | 2,401           | 2,518      | 426        | 2,856           | 3,235           | 1,387            | 91              | 12,914      |
| Euro             | 1,041           | 915        | 657        | 4,068           | 329             | —                | 50              | 7,060       |
| Other            | 761             | 794        | 292        | 395             | —               | —                | —               | 2,242       |
|                  | 4,204           | 4,346      | 2,070      | 9,110           | 9,082           | 1,430            | 2,892           | 33,134      |

| 2012 - final redemption | Group      |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 244        | —          | 629             | 5,471           | —                | 4,587           | 10,931      |
| US dollar               | 625        | 664        | 1,497           | 3,254           | —                | 5,898           | 11,938      |
| Euro                    | 1,474      | —          | 1,713           | 3,607           | 219              | 1,507           | 8,520       |
| Other                   | 42         | 425        | 751             | 909             | —                | 335             | 2,462       |
|                         | 2,385      | 1,089      | 4,590           | 13,241          | 219              | 12,327          | 33,851      |

| 2012 - call date | Group           |            |            |                 |                 |                  |                 | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                  | Currently<br>£m | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling         | —               | 464        | 60         | 826             | 7,221           | 135              | 2,225           | 10,931      |
| US dollar        | 1,469           | 3,300      | 664        | 3,128           | 1,939           | 1,345            | 93              | 11,938      |
| Euro             | —               | 2,914      | 289        | 2,833           | 2,220           | 219              | 45              | 8,520       |
| Other            | 9               | 715        | —          | 1,174           | 564             | —                | —               | 2,462       |
|                  | 1,478           | 7,393      | 1,013      | 7,961           | 11,944          | 1,699            | 2,363           | 33,851      |

| 2011 - final redemption | Group      |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 86         | 158        | 648             | 5,453           | —                | 3,247           | 9,592       |
| US dollar               | 325        | 555        | 2,976           | 1,316           | —                | 6,145           | 11,317      |
| Euro                    | 244        | 1,299      | 1,106           | 4,075           | 418              | 1,551           | 8,693       |
| Other                   | 29         | —          | 1,618           | 730             | —                | 345             | 2,722       |
|                         | 684        | 2,012      | 6,348           | 11,574          | 418              | 11,288          | 32,324      |

| 2011 - call date | Group           |            |            |                 |                 |                  |                 | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                  | Currently<br>£m | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling         | —               | 140        | 218        | 855             | 7,093           | 176              | 1,110           | 9,592       |
| US dollar        | 2,384           | 3,053      | 2,532      | 1,198           | 347             | 1,318            | 485             | 11,317      |
| Euro             | 159             | 2,128      | 1,299      | 1,922           | 2,720           | 418              | 47              | 8,693       |
| Other            | 9               | 1,407      | —          | 1,306           | —               | —                | —               | 2,722       |
|                  | 2,552           | 6,728      | 4,049      | 5,281           | 10,160          | 1,912            | 1,642           | 32,324      |

## Notes on the accounts

### 25 Subordinated liabilities continued

The following tables analyse the remaining contractual maturity of subordinated liabilities by the final redemption date and by the next call date.

| 2013 - final redemption | Bank       |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2014<br>£m | 2015<br>£m | 2016-2018<br>£m | 2019-2023<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 37         | 275        | —               | 5,000           | —                | 4,473           | 9,785       |
| US dollar               | 720        | 621        | 1,064           | 4,027           | —                | 5,284           | 11,716      |
| Euro                    | 194        | 657        | 2,953           | 1,717           | —                | 1,331           | 6,852       |
| Other                   | 395        | 617        | 99              | 813             | —                | 289             | 2,213       |
|                         | 1,346      | 2,170      | 4,116           | 11,557          | —                | 11,377          | 30,566      |

| 2013 - call date | Bank            |            |            |                 |                 |                  | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-------------|
|                  | Currently<br>£m | 2014<br>£m | 2015<br>£m | 2016-2018<br>£m | 2019-2023<br>£m | Thereafter<br>£m |             |
| Sterling         | 1               | 95         | 275        | 1,731           | 5,065           | 43               | 9,785       |
| US dollar        | 2,402           | 1,938      | 426        | 2,855           | 2,826           | 1,177            | 11,716      |
| Euro             | 1,041           | 757        | 657        | 4,068           | 329             | —                | 6,852       |
| Other            | 752             | 794        | 292        | 375             | —               | —                | 2,213       |
|                  | 4,196           | 3,584      | 1,650      | 9,029           | 8,220           | 1,220            | 30,566      |

| 2012 - final redemption | Bank       |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 217        | —          | 276             | 5,007           | —                | 4,078           | 9,578       |
| US dollar               | 620        | 664        | 1,497           | 3,040           | —                | 5,462           | 11,283      |
| Euro                    | 1,474      | —          | 1,713           | 3,607           | 219              | 1,308           | 8,321       |
| Other                   | 42         | 425        | 751             | 909             | —                | 326             | 2,453       |
|                         | 2,353      | 1,089      | 4,237           | 12,563          | 219              | 11,174          | 31,635      |

| 2012 - call date | Bank            |            |            |                 |                 |                  | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-------------|
|                  | Currently<br>£m | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m |             |
| Sterling         | —               | 217        | 60         | 386             | 6,725           | 135              | 9,578       |
| US dollar        | 1,469           | 2,859      | 664        | 3,127           | 1,726           | 1,345            | 11,283      |
| Euro             | —               | 2,760      | 289        | 2,833           | 2,220           | 219              | 8,321       |
| Other            | —               | 715        | —          | 1,174           | 564             | —                | 2,453       |
|                  | 1,469           | 6,551      | 1,013      | 7,520           | 11,235          | 1,699            | 31,635      |

| 2011 - final redemption | Bank       |            |                 |                 |                  |                 | Total<br>£m |
|-------------------------|------------|------------|-----------------|-----------------|------------------|-----------------|-------------|
|                         | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m | Perpetual<br>£m |             |
| Sterling                | 49         | 158        | 284             | 5,000           | —                | 2,893           | 8,384       |
| US dollar               | 61         | 555        | 2,976           | 1,316           | —                | 5,523           | 10,431      |
| Euro                    | 242        | 1,299      | 1,106           | 4,075           | 418              | 1,346           | 8,486       |
| Other                   | 20         | —          | 1,618           | 730             | —                | 345             | 2,713       |
|                         | 372        | 2,012      | 5,984           | 11,121          | 418              | 10,107          | 30,014      |

| 2011 - call date | Bank            |            |            |                 |                 |                  | Total<br>£m |
|------------------|-----------------|------------|------------|-----------------|-----------------|------------------|-------------|
|                  | Currently<br>£m | 2013<br>£m | 2014<br>£m | 2015-2017<br>£m | 2018-2022<br>£m | Thereafter<br>£m |             |
| Sterling         | —               | 103        | 158        | 404             | 6,700           | 79               | 8,384       |
| US dollar        | 1,759           | 2,792      | 2,532      | 1,198           | 347             | 1,318            | 10,431      |
| Euro             | —               | 2,127      | 1,299      | 1,922           | 2,720           | 418              | 8,486       |
| Other            | —               | 1,407      | —          | 1,306           | —               | —                | 2,713       |
|                  | 1,759           | 6,429      | 3,989      | 4,830           | 9,767           | 1,815            | 30,014      |

## Notes on the accounts

### 25 Subordinated liabilities continued

| Dated loan capital                                                                                                                                           | Capital treatment | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|------------|------------|------------|
| <i>The Bank</i>                                                                                                                                              |                   |            |            |            |
| €1,000 million 6% subordinated notes (redeemed May 2013)                                                                                                     | Lower Tier 2      | —          | 869        | 921        |
| US\$50 million floating rate subordinated notes (redeemed October 2013)                                                                                      | Lower Tier 2      | —          | 36         | 37         |
| €500 million 6% subordinated notes (redeemed May 2013)                                                                                                       | Lower Tier 2      | —          | 415        | 426        |
| £150 million 10.5% subordinated bonds (redeemed March 2013) <sup>(1)</sup>                                                                                   | Lower Tier 2      | —          | 164        | 171        |
| AUD397 million (2011 - AUD590 million) floating rate subordinated notes 2014<br>(callable quarterly from October 2009) <sup>(2)</sup>                        | Lower Tier 2      | 216        | 257        | 392        |
| AUD265 million (2011 - AUD410 million) floating rate subordinated notes 2014<br>(callable quarterly from October 2009) <sup>(2)</sup>                        | Lower Tier 2      | 144        | 171        | 272        |
| CAD217 million (2011 - CAD700 million) floating rate subordinated notes 2015<br>(callable quarterly from March 2010) <sup>(2)</sup>                          | Lower Tier 2      | 123        | 135        | 444        |
| £250 million 9.625% subordinated bonds 2015                                                                                                                  | Lower Tier 2      | 287        | 289        | 297        |
| US\$322 million (2011 - US\$750 million) floating rate Bermudian callable subordinated<br>notes 2015 (callable quarterly from September 2010) <sup>(2)</sup> | Lower Tier 2      | 195        | 199        | 485        |
| €750 million 4.875% subordinated notes 2015                                                                                                                  | Lower Tier 2      | 678        | 688        | 709        |
| CHF400 million 2.375% subordinated notes 2015                                                                                                                | Lower Tier 2      | 283        | 287        | 295        |
| CHF100 million 2.375% subordinated notes 2015 (callable annually from November 2013)                                                                         | Lower Tier 2      | 78         | 84         | 88         |
| CHF200 million 2.375% subordinated notes 2015                                                                                                                | Lower Tier 2      | 135        | 134        | 136        |
| US\$229 million (2011 - US\$500 million) floating rate subordinated notes 2016<br>(callable quarterly from October 2011) <sup>(2)</sup>                      | Lower Tier 2      | 139        | 142        | 324        |
| US\$686 million (2011 - US\$1,500 million) floating rate subordinated notes 2016<br>(callable quarterly from April 2011) <sup>(2)</sup>                      | Lower Tier 2      | 415        | 425        | 971        |
| €227 million (2011 - €500 million) floating rate subordinated notes 2016<br>(callable quarterly from January 2011) <sup>(2)</sup>                            | Lower Tier 2      | 189        | 185        | 420        |
| CHF34 million (2011 - CHF200 million) floating rate subordinated notes 2017<br>(callable annually from December 2012) <sup>(2)</sup>                         | Lower Tier 2      | 23         | 23         | 138        |
| €100 million floating rate subordinated notes 2017                                                                                                           | Lower Tier 2      | 83         | 82         | 84         |
| €102 million (2011 - €500 million) floating rate subordinated notes 2017<br>(callable quarterly from January 2012) <sup>(2)</sup>                            | Lower Tier 2      | 85         | 84         | 419        |
| €750 million 4.35% subordinated notes 2017                                                                                                                   | Lower Tier 2      | 712        | 721        | 723        |
| AUD50 (2011 - AUD450 million) floating rate subordinated notes 2017<br>(callable quarterly from February 2012) <sup>(2)</sup>                                | Lower Tier 2      | 27         | 32         | 303        |
| AUD90 million (2011 - AUD450 million) floating rate subordinated notes 2017<br>(callable quarterly from February 2012) <sup>(2)</sup>                        | Lower Tier 2      | 49         | 58         | 298        |
| US\$450 million (2011 - US\$1,500 million) floating rate subordinated step-up<br>notes 2017 (callable quarterly from August 2012) <sup>(2)</sup>             | Lower Tier 2      | 272        | 279        | 970        |
| €2,000 million 6.93% subordinated notes 2018                                                                                                                 | Lower Tier 2      | 1,996      | 2,033      | 2,023      |
| US\$125.6 million floating rate subordinated notes 2020                                                                                                      | Lower Tier 2      | 76         | 78         | 81         |
| €1,000 million 4.625% subordinated notes 2021 (callable quarterly from September 2016)                                                                       | Lower Tier 2      | 925        | 938        | 948        |
| €300 million CMS linked floating rate subordinated notes 2022                                                                                                | Lower Tier 2      | 234        | 272        | 271        |
| €144.4 million floating rate subordinated notes 2023                                                                                                         | Lower Tier 2      | 109        | 224        | 157        |
| AUD883 million 13.125% subordinated notes 2022 (callable annually from March 2017)                                                                           | Lower Tier 2      | 506        | 585        | —          |
| CAD420 million 10.5% subordinated notes 2022 (callable bi annually from September 2013)                                                                      | Lower Tier 2      | 246        | 269        | —          |
| CHF124 million 9.375% subordinated notes 2022 (callable annually from March 2017)                                                                            | Lower Tier 2      | 92         | 90         | —          |
| €564 million 10.5% subordinated notes 2022 (callable every 5 years from March 2017)                                                                          | Lower Tier 2      | 511        | 497        | —          |
| US\$2,132 million 9.5% subordinated notes 2022 (callable annually from March 2017)                                                                           | Lower Tier 2      | 1,323      | 1,350      | —          |

## Notes on the accounts

### 25 Subordinated liabilities continued

|                                                                                                     | Capital<br>treatment | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-----------------------------------------------------------------------------------------------------|----------------------|------------|------------|------------|
| <i>Due to the holding company</i>                                                                   |                      |            |            |            |
| US\$750 million 5% subordinated notes 2013 (redeemed November 2013) <sup>(3)</sup>                  | Lower Tier 2         | —          | 485        | 523        |
| US\$750 million 5% subordinated notes 2014 <sup>(3)</sup>                                           | Lower Tier 2         | 479        | 520        | 562        |
| US\$250 million 5% subordinated notes 2014 <sup>(3)</sup>                                           | Lower Tier 2         | 153        | 152        | 159        |
| US\$675 million 5.05% subordinated notes 2015 <sup>(3)</sup>                                        | Lower Tier 2         | 436        | 463        | 495        |
| US\$350 million 4.7% subordinated notes 2018 <sup>(3)</sup>                                         | Lower Tier 2         | 243        | 262        | 271        |
| £5,000 million floating subordinated notes 2019 <sup>(3)</sup>                                      | Lower Tier 2         | 5,001      | 5,008      | 5,002      |
| US\$2,250 million 6.125% subordinated notes 2022 <sup>(3)</sup>                                     | Lower Tier 2         | 1,232      | 1,398      | —          |
| US\$389 million 6.1% subordinated notes 2023 (issued July 2013) <sup>(3)</sup>                      | Lower Tier 2         | 232        | —          | —          |
| US\$2,000 million 6% subordinated notes 2023 (issued December 2013) <sup>(3)</sup>                  | Lower Tier 2         | 1,205      | —          | —          |
| <i>National Westminster Bank Plc</i>                                                                |                      |            |            |            |
| £300 million 7.875% subordinated notes 2015                                                         | Lower Tier 2         | 341        | 360        | 371        |
| £300 million 6.5% subordinated notes 2021                                                           | Lower Tier 2         | 373        | 410        | 400        |
| <i>Charter One Financial, Inc.</i>                                                                  |                      |            |            |            |
| US\$400 million 6.375% subordinated notes 2012                                                      |                      | —          | —          | 261        |
| US\$350 million 4.150% subordinated notes 2022                                                      | Ineligible           | 211        | 217        | —          |
| US\$333 million 4.771% subordinated notes 2023 (issued September 2013) <sup>(3)</sup>               | Ineligible           | 210        | —          | —          |
| US\$334 million 4.691% subordinated notes 2024 (issued December 2013) <sup>(3)</sup>                | Ineligible           | 210        | —          | —          |
| <i>First Active plc</i>                                                                             |                      |            |            |            |
| £60 million floating rate subordinated bonds 2018                                                   | Lower Tier 2         | 60         | 63         | 64         |
| <i>RBS Poland S.A.</i>                                                                              |                      |            |            |            |
| Polish Zloty 101 million floating rate subordinated notes 2018 (issued October 2013) <sup>(4)</sup> | Upper Tier 2         | 20         | —          | —          |
| <i>Non-controlling interests subordinated issues</i>                                                |                      |            |            |            |
|                                                                                                     |                      | 9          | 9          | 20         |
|                                                                                                     |                      | 20,566     | 21,442     | 20,931     |

#### Notes:

- (1) Unconditionally guaranteed by The Royal Bank of Scotland Group plc.
- (2) Partially repurchased following completion of an exchange offer in March 2012.
- (3) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
- (4) Issued to RBS N.V.
- (5) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
- (6) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.
- (7) Interest on all floating rate subordinated notes is calculated by reference to market rates.

## Notes on the accounts

### 25 Subordinated liabilities continued

#### Undated loan capital

|                                                                                                                                     | Capital<br>treatment | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------------------------------------------------------------------------------------------------------------|----------------------|------------|------------|------------|
| <i>The Bank</i>                                                                                                                     |                      |            |            |            |
| £31 million 4.956% undated subordinated notes                                                                                       | Upper Tier 2         | 31         | 31         | 31         |
| £51 million 6.25% undated subordinated notes (callable every five years from December 2012)                                         | Upper Tier 2         | 50         | 51         | 53         |
| £56 million 6% undated subordinated notes (callable every five years from September 2014)                                           | Upper Tier 2         | 59         | 61         | 62         |
| €176 million 5.125% undated subordinated notes (callable quarterly from July 2014)                                                  | Upper Tier 2         | 153        | 155        | 161        |
| €170 million floating rate undated subordinated notes (callable quarterly from July 2014)                                           | Upper Tier 2         | 141        | 138        | 141        |
| £54 million 5.125% undated subordinated notes (callable every five years from March 2016)                                           | Upper Tier 2         | 60         | 61         | 61         |
| £35 million 5.5% undated subordinated notes (callable every five years from December 2019)                                          | Upper Tier 2         | 39         | 39         | 37         |
| £21 million 6.2% undated subordinated notes (callable every five years from March 2022)                                             | Upper Tier 2         | 26         | 46         | 45         |
| £103 million 9.5% undated subordinated bonds (callable every five years from August 2018) <sup>(1)</sup>                            | Upper Tier 2         | 127        | 137        | 137        |
| £16 million (2011- £22 million) 5.625% undated subordinated notes<br>(callable every five years from September 2026) <sup>(1)</sup> | Upper Tier 2         | 24         | 24         | 23         |
| £19 million 5.625% undated subordinated notes (callable every five years from June 2032)                                            | Upper Tier 2         | 21         | 13         | 13         |
| £1 million floating rate undated subordinated notes (callable semi-annually from March 2011)                                        | Upper Tier 2         | 1          | 1          | 1          |
| CAD474 million 5.37% undated subordinated notes (callable quarterly from May 2016)                                                  | Upper Tier 2         | 291        | 328        | 347        |
| <i>Due to the holding company</i>                                                                                                   |                      |            |            |            |
| US\$350 million floating rate primary capital notes (callable semi-annually from December 1990) <sup>(2)</sup>                      | Upper Tier 2         | 212        | 217        | 226        |
| €1,250 million 6.467% perpetual regulatory tier one securities (callable quarterly from June 2012) <sup>(2)</sup>                   | Tier 1               | 1,041      | 1,019      | 1,083      |
| US\$1,200 million 7.648% perpetual regulatory securities (callable quarterly from September 2031) <sup>(2,3)</sup>                  | Tier 1               | 735        | 752        | 785        |
| £1,500 million floating rate perpetual subordinated notes <sup>(2)</sup>                                                            | Upper Tier 2         | 1,508      | 1,516      | 1,510      |
| US\$600 million floating rate perpetual subordinated notes (callable quarterly from October 2017) <sup>(2)</sup>                    | Upper Tier 2         | 363        | 371        | 388        |
| US\$1,600 million floating rate perpetual subordinated notes (callable quarterly from October 2017) <sup>(2)</sup>                  | Upper Tier 2         | 967        | 990        | 1,034      |
| £940 million floating rate perpetual subordinated notes <sup>(2)</sup>                                                              | Lower Tier 2         | 945        | 950        | 941        |
| US\$150 million 8% perpetual subordinated notes <sup>(2)</sup>                                                                      | Lower Tier 2         | 93         | 95         | —          |
| US\$136 million 7.75% perpetual subordinated notes <sup>(2)</sup>                                                                   | Lower Tier 2         | 82         | 84         | —          |
| £200 million floating rate perpetual subordinated notes <sup>(2)</sup>                                                              | Lower Tier 2         | 201        | 202        | —          |
| £885 million floating rate perpetual subordinated notes <sup>(2)</sup>                                                              | Lower Tier 2         | 885        | 885        | —          |
| £100 million floating rate perpetual subordinated notes <sup>(2)</sup>                                                              | Lower Tier 2         | 101        | 101        | —          |
| £420 million floating rate perpetual subordinated notes (issued July 2013) <sup>(2)</sup>                                           | Lower Tier 2         | 420        | —          | —          |

## Notes on the accounts

### 25 Subordinated liabilities continued

#### Undated loan capital

|                                                                                                    | Capital<br>treatment | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|----------------------------------------------------------------------------------------------------|----------------------|------------|------------|------------|
| <i>National Westminster Bank Plc</i>                                                               |                      |            |            |            |
| US\$193 million primary capital floating rate, Series A (callable semi-annually from July 1990)    | Upper Tier 2         | 117        | 119        | 124        |
| US\$229 million primary capital floating rate, Series B (callable semi-annually from August 1990)  | Upper Tier 2         | 139        | 142        | 148        |
| US\$285 million primary capital floating rate, Series C (callable quarterly from November 1990)    | Upper Tier 2         | 173        | 177        | 184        |
| €178 million floating rate subordinated notes (callable quarterly from October 2009)               | Upper Tier 2         | 149        | 146        | 150        |
| €10 million floating rate step-up notes (callable quarterly from October 2009)                     | Upper Tier 2         | 9          | 9          | 9          |
| £87 million floating rate subordinated step-up notes (callable every five years from January 2010) | Upper Tier 2         | 92         | 92         | 91         |
| £53 million 7.125% subordinated step-up notes (callable every five years from October 2022)        | Upper Tier 2         | 54         | 55         | 56         |
| £35 million 11.5% subordinated notes (callable any time from December 2022) (4)                    | Upper Tier 2         | 35         | 38         | 42         |
| <i>First Active plc</i>                                                                            |                      |            |            |            |
| £20 million 11.75% perpetual notes                                                                 | Lower Tier 2         | 25         | 25         | 26         |
| €38 million 11.375% perpetual notes                                                                | Lower Tier 2         | 52         | 46         | 48         |
| £1.3 million floating rate perpetual notes                                                         | Lower Tier 2         | 1          | 2          | 2          |
|                                                                                                    |                      | 9,422      | 9,118      | 7,959      |

#### Notes:

- (1) Guaranteed by the company.
- (2) On-lent from The Royal Bank of Scotland Group plc on a subordinated basis.
- (3) The company can satisfy interest payment obligations by issuing sufficient ordinary shares to appointed Trustees to enable them, on selling these shares, to settle the interest payment.
- (4) Exchangeable at the option of the issuer into 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.
- (5) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.
- (6) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
- (7) Interest on all floating rate subordinated notes is calculated by reference to market rates.

|                                                                             | Capital<br>treatment | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-----------------------------------------------------------------------------|----------------------|------------|------------|------------|
| <b>Preference shares</b>                                                    |                      |            |            |            |
| <i>The Bank</i>                                                             |                      |            |            |            |
| Non-cumulative preference shares of US\$0.01 (1)                            |                      |            |            |            |
| Series F US\$200 million 7.65% (callable any time from March 2007)          | Tier 1               | 121        | 123        | 129        |
| Series H US\$300 million 7.25% (callable any time from March 2004)          | Tier 1               | 181        | 186        | 194        |
| Series L US\$750 million 6.8% (callable any time from October 2009)         | Tier 1               | 453        | 465        | 485        |
| Series M US\$850 million 4.709% (callable quarterly from July 2013)         | Tier 1               | 514        | 528        | 554        |
| Series N US\$650 million 6.425% (callable quarterly from January 2034)      | Tier 1               | 456        | 524        | 548        |
| Series R US\$850 million 5.75% (callable quarterly from October 2009)       | Tier 1               | 514        | 526        | 549        |
| Series 1 US\$1,000 million 9.118% (callable any time from March 2010)       | Tier 1               | 619        | 633        | 661        |
| <i>National Westminster Bank Plc</i>                                        |                      |            |            |            |
| Non-cumulative preference shares of £1                                      |                      |            |            |            |
| - Series A £140 million 9% (not callable)                                   | Tier 1               | 143        | 145        | 145        |
| Non-cumulative preference shares of US\$25                                  |                      |            |            |            |
| - Series C US\$246 million 7.7628% (callable quarterly from April 2002) (2) | Tier 1               | 145        | 161        | 169        |
|                                                                             |                      | 3,146      | 3,291      | 3,434      |

#### Notes:

- (1) Issued to the holding company on terms which, in general, mirror the original issues by the holding company.
- (2) Series C preference shares each carry a gross dividend of 8.625% inclusive of associated tax credit. Redeemable at the option of the issuer at par.



## Notes on the accounts

### 26 Share capital and reserves

|                                              | Allotted, called up and fully paid |            |            |
|----------------------------------------------|------------------------------------|------------|------------|
|                                              | 2013<br>£m                         | 2012<br>£m | 2011<br>£m |
| Ordinary shares of £1                        | 6,609                              | 6,609      | 6,609      |
| Number of shares - millions                  |                                    |            |            |
| Ordinary shares of £1                        | 6,609                              | 6,609      | 6,609      |
| Non-cumulative preference shares of US\$0.01 | 59                                 | 59         | 59         |
| Non-cumulative preference shares of €0.01    | 1                                  | 1          | 1          |

#### Ordinary and preference shares

In 2013, one ordinary share was issued at a premium of £209 million on the cross-border merger with RBS Bank (Romania) S.A. in connection with the transfer of RBS N.V.'s Romania businesses to the company.

In 2012, one ordinary share was issued at a premium of £706 million on the cross-border merger with RBS II B.V. in connection with the transfer of substantially all of RBS N.V.'s Netherlands and EMEA businesses to the company.

No other shares were issued during 2013, 2012 or 2011.

#### Reserves

At 31 December 2013, the merger reserve comprises of the premium paid to acquire the assets and liabilities of RBS N.V.'s Korean business and the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

The Group received capital contributions of £2,870 million in 2012 and £4,539 million in 2011 from the parent company for which no additional share capital was issued. As such this has been recorded as a capital contribution in retained earnings.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

## Notes on the accounts

### 27 Leases

| Year in which receipt will occur | Finance lease contracts and hire purchase agreements |                                 |                       |                     | Operating lease assets:<br>future minimum lease rentals |
|----------------------------------|------------------------------------------------------|---------------------------------|-----------------------|---------------------|---------------------------------------------------------|
|                                  | Gross amounts<br>£m                                  | Present value adjustments<br>£m | Other movements<br>£m | Present value<br>£m | £m                                                      |
| 2013                             |                                                      |                                 |                       |                     |                                                         |
| Within 1 year                    | 3,452                                                | (300)                           | (44)                  | 3,108               | 186                                                     |
| After 1 year but within 5 years  | 5,991                                                | (534)                           | (251)                 | 5,206               | 341                                                     |
| After 5 years                    | 4,244                                                | (1,481)                         | (428)                 | 2,335               | 141                                                     |
| Total                            | 13,687                                               | (2,315)                         | (723)                 | 10,649              | 668                                                     |

|                                 |        |         |       |        |       |
|---------------------------------|--------|---------|-------|--------|-------|
| 2012                            |        |         |       |        |       |
| Within 1 year                   | 3,605  | (330)   | (40)  | 3,235  | 293   |
| After 1 year but within 5 years | 5,963  | (600)   | (197) | 5,166  | 512   |
| After 5 years                   | 4,984  | (1,709) | (315) | 2,960  | 291   |
| Total                           | 14,552 | (2,639) | (552) | 11,361 | 1,096 |

|                                 |        |         |       |        |       |
|---------------------------------|--------|---------|-------|--------|-------|
| 2011                            |        |         |       |        |       |
| Within 1 year                   | 3,996  | (340)   | (29)  | 3,627  | 406   |
| After 1 year but within 5 years | 6,806  | (763)   | (193) | 5,850  | 605   |
| After 5 years                   | 5,822  | (2,710) | (270) | 2,842  | 359   |
| Total                           | 16,624 | (3,813) | (492) | 12,319 | 1,370 |

| Nature of operating lease assets on the balance sheet | Group      |            |            |
|-------------------------------------------------------|------------|------------|------------|
|                                                       | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Transportation                                        | 822        | 1,501      | 1,592      |
| Cars and light commercial vehicles                    | 64         | 435        | 815        |
| Other                                                 | 243        | 267        | 298        |
|                                                       | 1,129      | 2,203      | 2,705      |

|                                            |      |       |       |
|--------------------------------------------|------|-------|-------|
| Amounts recognised as income and expense   |      |       |       |
| Finance leases - contingent rental income  | (94) | (110) | (133) |
| Operating leases - minimum rentals payable | 389  | 392   | 409   |

|                                                             |     |     |     |
|-------------------------------------------------------------|-----|-----|-----|
| Finance lease contracts and hire purchase agreements        |     |     |     |
| Accumulated allowance for uncollectable minimum receivables | 197 | 278 | 347 |

## Notes on the accounts

### 27 Leases continued

#### Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (see pages 233 to 236) and operating lease assets (see pages 280 and 281).

|                                      | Year in which residual value will be recovered |                                             |                                              |                        |             |
|--------------------------------------|------------------------------------------------|---------------------------------------------|----------------------------------------------|------------------------|-------------|
|                                      | Within 1<br>year<br>£m                         | After 1 year<br>but within<br>2 years<br>£m | After 2 years<br>but within<br>5 years<br>£m | After 5<br>years<br>£m | Total<br>£m |
| 2013                                 |                                                |                                             |                                              |                        |             |
| Operating leases                     |                                                |                                             |                                              |                        |             |
| - transportation                     | 197                                            | 34                                          | 217                                          | 134                    | 582         |
| - cars and light commercial vehicles | 18                                             | 8                                           | 7                                            | —                      | 33          |
| - other                              | 24                                             | 25                                          | 32                                           | 1                      | 82          |
| Finance lease contracts              | 41                                             | 53                                          | 198                                          | 429                    | 721         |
| Hire purchase agreements             | —                                              | 1                                           | 1                                            | —                      | 2           |
|                                      | 280                                            | 121                                         | 455                                          | 564                    | 1,420       |
| 2012                                 |                                                |                                             |                                              |                        |             |
| Operating leases                     |                                                |                                             |                                              |                        |             |
| - transportation                     | 284                                            | 182                                         | 207                                          | 333                    | 1,006       |
| - cars and light commercial vehicles | 317                                            | 44                                          | 49                                           | 1                      | 411         |
| - other                              | 30                                             | 19                                          | 39                                           | 3                      | 91          |
| Finance lease contracts              | 38                                             | 47                                          | 148                                          | 318                    | 551         |
| Hire purchase agreements             | 1                                              | —                                           | 1                                            | —                      | 2           |
|                                      | 670                                            | 292                                         | 444                                          | 655                    | 2,061       |
| 2011                                 |                                                |                                             |                                              |                        |             |
| Operating leases                     |                                                |                                             |                                              |                        |             |
| - transportation                     | 244                                            | 314                                         | 187                                          | 390                    | 1,135       |
| - cars and light commercial vehicles | 458                                            | 75                                          | 105                                          | 2                      | 640         |
| - other                              | 23                                             | 21                                          | 33                                           | 8                      | 85          |
| Finance lease contracts              | 26                                             | 48                                          | 147                                          | 270                    | 491         |
| Hire purchase agreements             | —                                              | —                                           | 1                                            | —                      | 1           |
|                                      | 751                                            | 458                                         | 473                                          | 670                    | 2,352       |

The Group provides asset finance to its customers through acting as a lessor. It purchases plant, equipment and intellectual property, renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

## Notes on the accounts

### 28 Structured entities

A structured entity (SE) is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SEs are also used in fund management activities to segregate custodial duties from the fund management advice.

The Group applies IFRS 10 'Consolidated Financial Statements' in determining whether or not to consolidate an SE. Entities, including SEs, are consolidated where the Group has power over the investee; exposure, or rights, to variable returns from its involvement with the entity; and the ability to use its power over the entity to affect the amount of the Group's returns.

### Consolidated structured entities

#### Securitisations

In a securitisation, assets, or interests in a pool of assets, are transferred generally to a SE which then issues liabilities to third party investors. The majority of securitisations are supported through liquidity facilities or other credit enhancements. The Group arranges securitisations to facilitate client transactions and undertakes own asset securitisations to sell or to fund portfolios of financial assets. The Group also acts as an underwriter and depositor in securitisation transactions in both client and proprietary transactions.

The Group's involvement in client securitisations takes a number of forms. It may: sponsor or administer a securitisation programme; provide liquidity facilities or programme-wide credit enhancement; and purchase securities issued by the vehicle.

#### Own asset securitisations

In own-asset securitisations, the pool of assets held by the SE is either originated by the Group, or (in the case of whole loan programmes) purchased from third parties.

The table below analyses the asset categories for those own-asset securitisations where the transferred assets continue to be recorded on the Group's balance sheet.

| Asset type        | 2013                     |               |             |        | Group<br>2012            |               |             |        | 2011                     |               |             |        |
|-------------------|--------------------------|---------------|-------------|--------|--------------------------|---------------|-------------|--------|--------------------------|---------------|-------------|--------|
|                   | Debt securities in issue |               |             |        | Debt securities in issue |               |             |        | Debt securities in issue |               |             |        |
|                   | Assets                   | Held by third | Held by the | Total  | Assets                   | Held by third | Held by the | Total  | Assets                   | Held by third | Held by the | Total  |
|                   | £m                       | parties       | Group (1)   | £m     | £m                       | parties       | Group (1)   | £m     | £m                       | parties       | Group (1)   | £m     |
| Mortgages         |                          |               |             |        |                          |               |             |        |                          |               |             |        |
| - UK              | 14,434                   | 4,876         | 10,978      | 15,854 | 16,448                   | 6,462         | 11,963      | 18,425 | 49,269                   | 10,732        | 47,324      | 58,056 |
| - Irish           | 9,300                    | 1,890         | 8,751       | 10,641 | 10,587                   | 3,217         | 7,634       | 10,851 | 12,660                   | 3,472         | 8,670       | 12,142 |
| UK credit cards   | 3,261                    | 500           | 1,625       | 2,125  | 3,019                    | 1,243         | 1,736       | 2,979  | 4,037                    | 500           | 110         | 610    |
| UK personal loans | 3,382                    | —             | 3,677       | 3,677  | 4,658                    | —             | 4,283       | 4,283  | 5,168                    | —             | 4,706       | 4,706  |
| Other loans (2)   | 11,848                   | 71            | 12,078      | 12,149 | 17,215                   | 352           | 18,064      | 18,416 | 19,778                   | 4             | 20,577      | 20,581 |
|                   | 42,225                   | 7,337         | 37,109      | 44,446 | 51,927                   | 11,274        | 43,680      | 54,954 | 90,912                   | 14,708        | 81,387      | 96,095 |
| Cash deposits     | 6,245                    |               |             |        | 5,366                    |               |             |        | 11,164                   |               |             |        |
|                   | 48,470                   |               |             |        | 57,293                   |               |             |        | 102,076                  |               |             |        |

Notes:

(1) Debt securities retained by the Group may be pledged with central banks.

(2) Corporate, social housing and student loans.

### Commercial paper conduits

The Group consolidates a number of asset-backed commercial paper (ABCP) conduits. A conduit is an SE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months. At 31 December 2013, assets held by the conduits totalled £1.6 billion (2012 - £3.6 billion; 2011 - £13.1 billion). At 31 December 2013 and at 31 December 2012 the conduits were funded entirely by the Group.

### Covered bond programme

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of debt securities by the Group. The Group retains all of the risks and rewards of these loans, the partnerships are consolidated, the loans retained on the Group's balance sheet and the related covered bonds included within debt securities in issue. At 31 December 2013, £16,177 million of mortgages provided security for debt securities in issue of £9,041 million (2012 - mortgages £15,990 million, bonds £10,139 million; 2011 - mortgages £15,441 million, bonds £9,107 million).

## Notes on the accounts

### 28 Structured entities *continued* Unconsolidated structured entities

The Group's interests in unconsolidated structured entities are analysed below.

|                                       | Asset-backed securitisation vehicles |               | Investment |       |        |
|---------------------------------------|--------------------------------------|---------------|------------|-------|--------|
|                                       | Sponsored                            | Not sponsored | funds      | Other | Total  |
|                                       | £m                                   | £m            | £m         | £m    | £m     |
| Held for trading                      |                                      |               |            |       |        |
| Loans and advances to customers       | 1                                    | 1             | —          | 284   | 286    |
| Debt securities                       | 203                                  | 9,405         | 176        | 54    | 9,838  |
| Equity shares                         | —                                    | 1             | 588        | —     | 589    |
| Derivatives - assets                  | 261                                  | 142           | 22         | 1,278 | 1,703  |
| Derivatives - liabilities             | (112)                                | —             | (140)      | (420) | (672)  |
| Total                                 | 353                                  | 9,549         | 646        | 1,196 | 11,744 |
| Other than held-for-trading           |                                      |               |            |       |        |
| Loans and advances to customers       | —                                    | 3,967         | —          | 30    | 3,997  |
| Debt securities                       | 481                                  | 15,130        | 8          | 1     | 15,620 |
| Total                                 | 481                                  | 19,097        | 8          | 31    | 19,617 |
| Liquidity facilities/loan commitments | 4                                    | 2,630         | —          | 233   | 2,867  |
| Guarantees                            | —                                    | 83            | —          | 9     | 92     |
| Total exposure                        | 838                                  | 31,359        | 654        | 1,469 | 34,320 |

Notes:

- (1) Net income arising from interests in unconsolidated structured entities include interest receivable, trading income as a result of changes in fair value, foreign exchange gains/losses and other income less impairments that may be required.
- (2) A sponsored entity is a structured entity, established by the Group where the Group provides liquidity and/or credit enhancements or provides ongoing services to the entity. The Group can act as sponsor for its own or for customers' transactions.
- (3) In 2013 the Group transferred £2,119 million of assets into sponsored structured entities which are not consolidated in the Group and for which the Group holds no interest at 31 December 2013. The income arising from these entities was £192 million.

## Notes on the accounts

### 29 Asset transfers

Under IAS 39 a financial asset is transferred if the Group either (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. Following a transfer the financial asset will be derecognised; not derecognised and retained in full on the Group's balance sheet; or continue to be recognised on the balance sheet to the extent of the Group's continuing involvement.

#### Transfers that do not qualify for derecognition

##### Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice.

Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if the Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included on the balance sheet, are set out below. All of these securities could be sold or repledged by the holder.

|                                                                                     | Group      |            |            | Bank       |            |            |
|-------------------------------------------------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                                                                     | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Assets subject to securities repurchase agreements or security lending transactions |            |            |            |            |            |            |
| Debt securities                                                                     | 51,970     | 87,159     | 72,652     | 30,546     | 55,320     | 37,166     |
| Equity shares                                                                       | 5,118      | 6,772      | 5,256      | 5,118      | 6,772      | 5,245      |

The following table provides analyses of assets that have been transferred but have failed the derecognition rules under IAS 39 and therefore continue to be recognised on the Bank's balance sheet.

| Asset type        | Bank           |                |            |
|-------------------|----------------|----------------|------------|
|                   | 2013 (1)<br>£m | 2012 (1)<br>£m | 2011<br>£m |
| UK mortgages      | 10,832         | 11,859         | 25,267     |
| UK credit cards   | 1,185          | 1,128          | 1,560      |
| UK personal loans | 928            | 1,238          | 1,374      |
| Other loans (2)   | 6,405          | 9,226          | 12,463     |
|                   | 19,350         | 23,451         | 40,664     |

Notes:

(1) The fair value of the transferred assets is £18,949 million (2012 - £22,273 million) where recourse is to these assets only.

(2) Comprises corporate, social housing and student loans.

## Notes on the accounts

### 29 Asset transfers continued

#### Transfers that continue to be recognised to the extent of the Group's continuing involvement (IAS 39)

In certain securitisations of US residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control of the assets and continues to recognise the assets to the extent of its continuing involvement, as defined by IAS 39, which takes the form of retaining certain subordinated bonds issued by the securitisation vehicles.

These interests relate predominantly to mortgage-backed securities which were re-securitised. Retained interests are generally not held to maturity and are typically sold after settlement of the securitisation. Retained interests may be subordinated to other investors' interests. Third party investors and securitisation trusts have no recourse to the Group's other assets for failure of debtors to perform on the securitised loans or securities, effectively transferring the risk of future credit losses to the purchasers of the securities issued by the trust.

The value of the retained interest varies and is subject to credit, interest rate, prepayment, and other risks of the transferred assets. In the ordinary course of business, the Group does not provide any other financial support to the securitisation trusts other than holding these retained interests. At 31 December 2013, securitised assets were £0.3 billion (2012 - £0.4 billion; 2011 - £0.6 billion); retained interest at fair value £59 million (2012 - £61 million; 2011 - £72 million); subordinated assets £35 million (2012 - £1 million; 2011 - £3 million); and related liabilities £35 million (2012 - £1 million; 2011 - £3 million).

#### Transfers that qualify for derecognition but in which the Group has continuing involvement (IFRS 7)

The Group has transferred and derecognised certain assets but it has continuing involvement, as defined in IFRS 7, in them through holdings of debt securities with a carrying value at 31 December 2013 of £389 million and fair value of £345 million (2012: carrying value - £398 million; fair value - £339 million). Income for 2013 was £11 million (2012 - £13 million).

#### Assets pledged as collateral

The Group pledges collateral with its counterparties in respect of derivative liabilities and bank and other borrowings.

|                                           | Group         |               |               | Bank          |               |               |
|-------------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                                           | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    |
| <b>Assets pledged against liabilities</b> |               |               |               |               |               |               |
| Loans and advances to banks               | 9,672         | 11,553        | 18,030        | 9,050         | 11,545        | 18,021        |
| Loans and advances to customers           | 23,328        | 24,814        | 51,447        | 17,883        | 23,040        | 21,694        |
| Securities                                | 8,034         | 16,371        | 3,690         | 5,229         | 12,365        | 694           |
|                                           | <b>41,034</b> | <b>52,738</b> | <b>73,167</b> | <b>32,162</b> | <b>46,950</b> | <b>40,409</b> |
| <b>Liabilities secured by assets</b>      |               |               |               |               |               |               |
| Deposits by banks                         | 3,254         | 9,409         | 6,346         | 581           | 7,433         | 3             |
| Customer accounts                         | 2,766         | 3,000         | 2,663         | —             | —             | —             |
| Derivatives                               | 40,744        | 56,738        | 75,513        | 40,195        | 56,089        | 74,481        |
|                                           | <b>46,764</b> | <b>69,147</b> | <b>84,522</b> | <b>40,776</b> | <b>63,522</b> | <b>74,484</b> |

## Notes on the accounts

### 30 Capital resources

The Group's regulatory capital resources in accordance with PRA definitions were as follows:

|                                                                   | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|-------------------------------------------------------------------|------------|------------|------------|
| <b>Shareholders' equity (excluding non-controlling interests)</b> |            |            |            |
| Shareholders' equity                                              | 48,786     | 59,288     | 61,726     |
| Other equity instruments                                          | (1,421)    | (1,421)    | (1,421)    |
|                                                                   | 47,365     | 57,867     | 60,305     |
| <b>Non-controlling interests</b>                                  | 79         | 137        | 128        |
| <b>Regulatory adjustments and deductions</b>                      |            |            |            |
| Own credit                                                        | 1,519      | 1,563      | (1,157)    |
| Defined benefit pension fund adjustment                           | 362        | 913        | —          |
| Net unrealised AFS gains                                          | (359)      | (1,750)    | (2,220)    |
| Cash flow hedging reserve                                         | 86         | (1,815)    | (1,018)    |
| Other regulatory adjustments                                      | 50         | 10         | (230)      |
| Goodwill and other intangible assets                              | (12,352)   | (12,403)   | (12,365)   |
| 50% of expected losses less impairment provisions                 | (54)       | (1,954)    | (2,553)    |
| 50% of securitisation positions                                   | (722)      | (1,001)    | (1,605)    |
| 50% of APS first loss                                             | —          | —          | (2,763)    |
|                                                                   | (11,470)   | (16,437)   | (23,911)   |
| <b>Core Tier 1 capital</b>                                        | 35,974     | 41,567     | 36,522     |
| <b>Other Tier 1 capital</b>                                       |            |            |            |
| Preference shares - debt                                          | 2,745      | 2,759      | 2,857      |
| Innovative/hybrid Tier 1 securities                               | 3,502      | 3,551      | 3,645      |
|                                                                   | 6,247      | 6,310      | 6,502      |
| <b>Tier 1 deductions</b>                                          |            |            |            |
| 50% of material holdings                                          | (409)      | (239)      | (235)      |
| Tax on expected losses less impairment provisions                 | 16         | 634        | 920        |
|                                                                   | (393)      | 395        | 685        |
| <b>Total Tier 1 capital</b>                                       | 41,828     | 48,272     | 43,709     |



## Notes on the accounts

### 30 Capital resources continued

|                                                       | 2013<br>£m    | 2012<br>£m    | 2011<br>£m    |
|-------------------------------------------------------|---------------|---------------|---------------|
| <b>Qualifying Tier 2 capital</b>                      |               |               |               |
| Undated subordinated debt                             | 4,716         | 4,814         | 4,916         |
| Dated subordinated debt - net of amortisation         | 18,371        | 18,121        | 17,272        |
| Unrealised gains on AFS equity shares                 | 111           | 40            | 106           |
| Collectively assessed impairment provisions           | 375           | 379           | 584           |
| Non-controlling Tier 2 capital                        | —             | —             | 11            |
|                                                       | 23,573        | 23,354        | 22,889        |
| <b>Tier 2 deductions</b>                              |               |               |               |
| 50% of securitisation positions                       | (722)         | (1,001)       | (1,605)       |
| 50% of standardised losses less impairment provisions | (70)          | (2,588)       | (3,473)       |
| 50% of material holdings                              | (409)         | (239)         | (235)         |
| 50% of APS first loss                                 | —             | —             | (2,763)       |
|                                                       | (1,201)       | (3,828)       | (8,076)       |
| <b>Total Tier 2 capital</b>                           | <b>22,372</b> | <b>19,526</b> | <b>14,813</b> |
| <b>Supervisory deductions</b>                         |               |               |               |
| Unconsolidated investments                            | (36)          | (37)          | (111)         |
| Other deductions                                      | (217)         | (193)         | (184)         |
|                                                       | (253)         | (230)         | (295)         |
| <b>Total regulatory capital</b>                       | <b>63,947</b> | <b>67,568</b> | <b>58,227</b> |

In the management of capital resources, the Group is governed by the RBS Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the RBS Group has regard to the supervisory requirements of the PRA. The PRA uses risk asset ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. The Group has complied with the PRA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally banking entities, are subject to various individual regulatory capital requirements in the UK and overseas. Furthermore, the payment of dividends by subsidiaries and the ability of members of the RBS Group to lend money to other members of the RBS Group may be subject to restrictions such as local regulatory or legal requirements, the availability of reserves and financial and operating performance.

## Notes on the accounts

### 31 Memorandum items

#### Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December 2013. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

|                                                                               | Group          |                |                | Bank           |                |                |
|-------------------------------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
|                                                                               | 2013<br>£m     | 2012<br>£m     | 2011<br>£m     | 2013<br>£m     | 2012<br>£m     | 2011<br>£m     |
| <b>Contingent liabilities</b>                                                 |                |                |                |                |                |                |
| Guarantees and assets pledged as collateral security                          | 16,709         | 15,413         | 15,142         | 12,842         | 11,412         | 9,965          |
| Other contingent liabilities                                                  | 5,584          | 9,760          | 8,999          | 3,731          | 7,959          | 7,304          |
|                                                                               | 22,293         | 25,173         | 24,141         | 16,573         | 19,371         | 17,269         |
| <b>Commitments</b>                                                            |                |                |                |                |                |                |
| Undrawn formal standby facilities, credit lines and other commitments to lend |                |                |                |                |                |                |
| - less than one year                                                          | 77,212         | 82,753         | 97,501         | 22,920         | 28,488         | 43,893         |
| - one year and over                                                           | 135,141        | 129,396        | 123,644        | 107,287        | 107,054        | 101,579        |
| Other commitments                                                             | 2,442          | 1,589          | 2,830          | 2,320          | 1,382          | 59             |
|                                                                               | 214,795        | 213,738        | 223,975        | 132,527        | 136,924        | 145,531        |
| <b>Total contingent liabilities and commitments</b>                           | <b>237,088</b> | <b>238,911</b> | <b>248,116</b> | <b>149,100</b> | <b>156,295</b> | <b>162,800</b> |

Note:

(1) In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

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

#### Contingent liabilities

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

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

#### Commitments

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

**Other commitments** - these include documentary credits, which are commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents, forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, and other short-term trade related transactions.

#### Capital Support Deed

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

## Notes on the accounts

### 31 Memorandum items continued

#### Contractual obligations for future expenditure not provided for in the accounts

The following table shows contractual obligations for future expenditure not provided for in the accounts at the year end.

|                                                                 | Group |       |       | Bank  |       |       |
|-----------------------------------------------------------------|-------|-------|-------|-------|-------|-------|
|                                                                 | 2013  | 2012  | 2011  | 2013  | 2012  | 2011  |
|                                                                 | £m    | £m    | £m    | £m    | £m    | £m    |
| <b>Operating leases</b>                                         |       |       |       |       |       |       |
| Minimum rentals payable under non-cancellable leases (1)        |       |       |       |       |       |       |
| - within 1 year                                                 | 348   | 375   | 394   | 148   | 161   | 164   |
| - after 1 year but within 5 years                               | 1,143 | 1,213 | 1,321 | 524   | 547   | 585   |
| - after 5 years                                                 | 2,144 | 2,261 | 2,489 | 1,388 | 1,419 | 1,523 |
|                                                                 | 3,635 | 3,849 | 4,204 | 2,060 | 2,127 | 2,272 |
| <b>Property, plant and equipment</b>                            |       |       |       |       |       |       |
| Contracts to buy assets to be leased under operating leases (2) | —     | —     | 2,607 | —     | —     | —     |
| Other capital expenditure                                       | 38    | 37    | 35    | 20    | 17    | 19    |
|                                                                 | 38    | 37    | 2,642 | 20    | 17    | 19    |
| <b>Contracts to purchase goods or services (3)</b>              | 1,162 | 959   | 1,130 | 1,112 | 895   | 1,044 |
|                                                                 | 4,835 | 4,845 | 7,976 | 3,192 | 3,039 | 3,335 |
| <b>Included above are obligations to fellow subsidiaries</b>    |       |       |       |       |       |       |
| Within 1 year                                                   | —     | —     | 7     | —     | —     | 7     |
| After 1 year but within 5 years                                 | —     | —     | 28    | —     | —     | 27    |
| After 5 years                                                   | —     | —     | 28    | —     | —     | 28    |
|                                                                 | —     | —     | 63    | —     | —     | 62    |

Notes:  
(1) Predominantly property leases.  
(2) Amount related to RBS Aviation Capital which was sold in 2012. Included £486 million due within one year.  
(3) Of which due within 1 year: Group - £373 million (2012 - £444 million; 2011 - £483 million) and Bank - £334 million (2012 - £386 million; 2011 - £405 million).

#### Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £408 million (2012 - £414 million; 2011 - £416 million) from these activities.

#### The Financial Services Compensation Scheme

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

The FSCS has borrowed from HM Treasury to fund compensation costs associated with the failure of Bradford & Bingley, Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki 'Icesave' and London Scottish Bank plc. The interest rate on these borrowings is subject to a floor being the higher of 12 month LIBOR plus 100 basis points or the relevant gilt rate for the equivalent cost of borrowing from HMT. The FSCS and HM Treasury have agreed that the period of these loans will reflect the expected timetable for recoveries from the estates of Bradford & Bingley and the other failed banks. The FSCS will levy the deposit taking sector for its share of the balance of the principal outstanding for the non-Bradford & Bingley loan prior to the FSCS loan facility with HMT expiring in March 2016. In addition, the FSCS recently announced HMT's intention to collect an interim payment relating to resolution costs for Dunfermline Building Society of £100 million. The capital element of the levy is expected to rise to £399 million (£363 million in the 2013/14 scheme year).

The Group has accrued £144 million for its share of estimated FSCS levy for the 2013/14 and 2014/15 scheme years.

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## Notes on the accounts

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### 31 Memorandum items continued

#### Litigation, investigations and reviews

Arising out of their normal business operations, the Bank and other members of the RBS Group are party to legal proceedings and the subject of investigation and other regulatory and governmental action in the United Kingdom, the United States and other jurisdictions.

The RBS Group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation resulting from past events, and a reliable estimate can be made of the amount of the obligation. While the outcome of the legal proceedings, investigations and regulatory and governmental matters in which the RBS Group is involved is inherently uncertain, the directors believe that, based on the information available to them, appropriate provisions have been made in respect of legal proceedings, investigations and regulatory and governmental matters as at 31 December 2013 (see Note 23). The litigation provision reflects in large part the £1.9 billion provision taken in the last quarter of 2013 primarily related to mortgage-backed securities and securities related litigation and investigations. The future outflow of resources in respect of any matter may ultimately prove to be substantially greater than or less than the aggregate provision that the RBS Group has recognised.

In many proceedings, it is not possible to determine whether any loss is probable or to estimate the amount of any loss. Numerous legal and factual issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a liability can be reasonably estimated for any claim. The RBS Group cannot predict if, how, or when such claims will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for claims that are at an early stage in their development or where claimants seek substantial or indeterminate damages.

There are also situations where the RBS Group may enter into a settlement agreement. This may occur in order to avoid the expense, management distraction or reputational implications of continuing to contest liability, even for those matters for which the RBS Group believes it has credible defences and should prevail on the merits. The uncertainties inherent in all such matters affect the amount and timing of any potential outflows for both matters with respect to which provisions have been established and other contingent liabilities.

Other than those discussed below, no member of the Group is or has been involved in governmental, legal or regulatory proceedings (including those which are pending or threatened) that are material individually or in aggregate.

#### Litigation

##### Shareholder litigation

RBSG and certain of its subsidiaries, together with certain current and former officers and directors were named as defendants in purported class actions filed in the United States District Court for the Southern District of New York involving holders of RBS preferred shares (the Preferred Shares litigation) and holders of American Depositary Receipts (the ADR claims).

In the Preferred Shares litigation, the consolidated amended complaint alleged certain false and misleading statements and omissions in public filings and other communications during the period 1 March 2007 to 19 January 2009, and variously asserted claims under Sections 11, 12 and 15 of the US Securities Act of 1933, as amended (Securities Act). The putative class is composed of all persons who purchased or otherwise acquired RBS Group Series Q, R, S, T and/or U non-cumulative dollar preference shares issued pursuant or traceable to the 8 April 2005 US Securities and Exchange Commission (SEC) registration statement. In September 2012, the Court dismissed the Preferred Shares litigation with prejudice. On 25 September 2013, the United States Court of Appeals for the Second Circuit (Second Circuit Court of Appeals) affirmed the lower Court's dismissal of the litigation. The deadline for plaintiffs to appeal from the Second Circuit Court of Appeals to the United States Supreme Court has expired.

With respect to the ADR claims, a consolidated amended complaint asserting claims under Sections 10 and 20 of the US Securities Exchange Act of 1934 and Sections 11, 12 and 15 of the Securities Act was filed in November 2011 on behalf of all persons who purchased or otherwise acquired RBSG's American Depositary Receipts (ADRs) from issuance through 20 January 2009. In September 2012, the Court dismissed the ADR claims with prejudice. On 5 August 2013, the Court denied the plaintiffs' motions for reconsideration and for leave to re-plead their case. The plaintiffs have appealed the dismissal of this case to the Second Circuit Court of Appeals, and that appeal is in the process of being briefed by the parties.

Additionally, between March and July 2013, claims were issued in the High Court of Justice of England and Wales by sets of current and former shareholders, against the RBS Group (and in one of those claims, also against certain former individual officers and directors) alleging that untrue and misleading statements and/or improper omissions were made in connection with the rights issue announced by the RBS Group on 22 April 2008 in breach of the Financial Services and Markets Act 2000. On 30 July 2013 these and other similar threatened claims were consolidated by the Court via a Group Litigation Order. The RBS Group's defence to the claims was filed on 13 December 2013.

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## Notes on the accounts

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### 31 Memorandum items continued

#### Other securitisation and securities related litigation in the United States

RBS Group companies have been named as defendants in their various roles as issuer, depositor and/or underwriter in a number of claims in the United States that relate to the securitisation and securities underwriting businesses. These cases include actions by individual purchasers of securities and purported class action suits. Together, the pending individual and class action cases involve the issuance of more than US\$67 billion of mortgage-backed securities (MBS) issued primarily from 2005 to 2007. Although the allegations vary by claim, in general, plaintiffs in these actions claim that certain disclosures made in connection with the relevant offerings contained materially false or misleading statements and/or omissions regarding the underwriting standards pursuant to which the mortgage loans underlying the securities were issued. RBS Group companies remain as defendants in more than 40 lawsuits brought by purchasers of MBS, including the purported class actions identified below.

Among these MBS lawsuits are four cases filed on 2 September 2011 by the US Federal Housing Finance Agency (FHFA) as conservator for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). The primary FHFA lawsuit remains pending in the United States District Court for the District of Connecticut, and it relates to approximately US\$32 billion of MBS for which RBS Group entities acted as sponsor/depositor and/or lead underwriter or co-lead underwriter. Of these approximately US\$10.5 billion were outstanding at 31 December 2013 with cumulative losses of approximately US\$0.9 billion (being the loss of principal value suffered by security holders). On 30 September 2013, the Court denied the defendants' motion to dismiss FHFA's amended complaint in this case. Discovery is ongoing.

The other three FHFA lawsuits (against Ally Financial Group, Countrywide Financial Corporation and Nomura) name RBS Securities Inc. as a defendant by virtue of the fact that it was an underwriter of some of the securities at issue. Two of these cases are part of a coordinated proceeding in the United States District Court for the Southern District of New York in which discovery is underway. The third case (the Countrywide matter) is pending in the United States District Court for the Central District of California. Two other FHFA lawsuits (against JP Morgan and Morgan Stanley) in which RBS Securities Inc. was an underwriter defendant have been settled without any contribution from RBS Securities Inc.

Other MBS lawsuits against RBS Group companies include three cases filed by the National Credit Union Administration Board (on behalf of US Central Federal Credit Union, Western Corporate Federal Credit Union, Southwest Corporate Federal Credit Union, and Members United Corporate Federal Credit Union) and six cases filed by the Federal Home Loan Banks of Boston, Chicago, Indianapolis, Seattle and San Francisco.

The purported MBS class actions in which RBS Group companies are defendants include New Jersey Carpenters Health Fund v. Novastar Mortgage Inc. et al. and In re IndyMac Mortgage-Backed Securities Litigation. A third MBS class action, New Jersey Carpenters Vacation Fund et al. v. The Royal Bank of Scotland plc et al., has been settled in principle for US\$275 million subject to documentation and court approval. There is a provision that fully covers the settlement amount. The case relates to more than US\$15 billion of the issued MBS that are the subject of MBS claims pending against RBS Group companies. The outcome in this case should not be seen as indicative of how other MBS lawsuits may be resolved.

RBS Securities Inc. was also a defendant in Luther v. Countrywide Financial Corp. et al. and related class action cases (the "Luther Litigation"). On 5 December 2013, the court granted final approval of a US\$500 million settlement of plaintiffs' claims to be paid by Countrywide without contribution from RBS Securities Inc. Several members of the settlement class are appealing the court-approved settlement to the United States Court of Appeals for the Ninth Circuit.

Certain other institutional investors have threatened to bring claims against the RBS Group in connection with various mortgage-related offerings. The RBS Group cannot predict whether any of these individual investors will pursue these threatened claims (or their outcome), but expects that several may. If such claims are asserted and were successful, the amounts involved may be material.

In many of these actions, the RBS Group has or will have contractual claims to indemnification from the issuers of the securities (where an RBS Group company is underwriter) and/or the underlying mortgage originator (where an RBS Group company is issuer). The amount and extent of any recovery on an indemnification claim, however, is uncertain and subject to a number of factors, including the ongoing creditworthiness of the indemnifying party.

#### London Interbank Offered Rate (LIBOR)

Certain members of the RBS Group have been named as defendants in a number of class actions and individual claims filed in the US with respect to the setting of LIBOR and certain other benchmark interest rates. The complaints are substantially similar and allege that certain members of the RBS Group and other panel banks individually and collectively violated various federal laws, including the US commodities and antitrust laws, and state statutory and common law, as well as contracts, by manipulating LIBOR and prices of LIBOR-based derivatives in various markets through various means.

Most of the USD LIBOR-related actions in which RBS Group companies are defendants, including all purported class actions relating to USD LIBOR, have been transferred to a coordinated proceeding in the United States District Court for the Southern District of New York. In the coordinated proceeding, consolidated class action complaints were filed on behalf of (1) exchange-based purchaser plaintiffs, (2) over-the-counter purchaser plaintiffs, and (3) corporate debt purchaser plaintiffs. On 29 March 2013, the Court dismissed plaintiffs' antitrust claims, claims under RICO (Racketeer Influenced and Corrupt Organizations Act), and certain state law claims, but declined to dismiss certain other claims. Discovery is stayed. Over 35 other USD LIBOR-related actions involving RBS have been stayed pending further order from the Court.

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## Notes on the accounts

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### 31 Memorandum items continued

Certain members of the RBS Group have also been named as defendants in class actions relating to (i) JPY LIBOR and Euroyen TIBOR (the "Yen action") and (ii) Euribor (the "Euribor action"), both of which are pending in the United States District Court for the Southern District of New York.

Details of LIBOR investigations and their outcomes affecting the RBS Group are set out under 'Investigations and reviews' below.

#### Credit default swap antitrust litigation

Certain members of the RBS Group, as well as a number of other financial institutions, are defendants in a consolidated antitrust class action pending in the United States District Court for the Southern District of New York. The plaintiffs generally allege that defendants violated the U.S. antitrust laws by restraining competition in the market for credit default swaps through various means and thereby causing inflated bid-ask spreads for credit default swaps.

#### FX antitrust litigation

Certain members of the RBS Group, as well as a number of other financial institutions, have been named as defendants in multiple antitrust class action complaints filed in the United States District Court for the Southern District of New York since November 2013. The plaintiffs generally allege that the defendants violated the U.S. antitrust laws, state statutes, and the common law by conspiring to manipulate the foreign exchange market by manipulating benchmark foreign exchange rates.

#### Thornburg adversary proceeding

RBS Securities Inc. and certain other RBS Group companies, as well as several other financial institutions, are defendants in an adversary proceeding filed in the U.S. bankruptcy court in Maryland by the trustee for TMST, Inc. (formerly known as Thornburg Mortgage, Inc.). The trustee seeks recovery of transfers made under certain restructuring agreements as, among other things, avoidable fraudulent and preferential conveyances and transfers.

#### Investigations and reviews

The Group's businesses and financial condition can be affected by the fiscal or other policies and actions of various governmental and regulatory authorities in the United Kingdom, the European Union, the United States and elsewhere. Members of the RBS Group have engaged, and will continue to engage, in discussions with relevant governmental and regulatory authorities, including in the United Kingdom, the European Union, the United States and elsewhere, on an ongoing and regular basis regarding operational, systems and control evaluations and issues including those related to compliance with applicable anti-bribery, anti-money laundering and sanctions regimes. It is possible that any matters discussed or identified may result in investigatory or other action being taken by governmental and regulatory authorities, increased costs being incurred by the RBS Group, remediation of systems and controls, public or private censure, restriction of the RBS Group's business activities or fines. Any of the events or circumstances mentioned below could have a material adverse effect on the RBS Group, its business, authorisations and licences, reputation, results of operations or the price of securities issued by it.

The RBS Group is co-operating fully with the investigations and reviews described below.

#### LIBOR, other trading rates and foreign exchange rates

On 6 February 2013, the RBS Group announced settlements with the Financial Services Authority in the United Kingdom, the United States Commodity Futures Trading Commission and the United States Department of Justice (DOJ) in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). The RBS Group agreed to pay penalties of £87.5 million, US\$325 million and US\$150 million to these authorities respectively to resolve the investigations. As part of the agreement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement in relation to one count of wire fraud relating to Swiss Franc LIBOR and one count for an antitrust violation relating to Yen LIBOR. In addition, on 12 April 2013, RBS Securities Japan Limited entered a plea of guilty to one count of wire fraud relating to Yen LIBOR and on 6 January 2014, the US District Court for the District of Connecticut entered a final judgment in relation to the conviction of RBS Securities Japan Limited pursuant to the plea agreement. On 12 April 2013, RBS Securities Japan Limited received a business improvement order from Japan's Financial Services Agency requiring RBS to take remedial steps to address certain matters, including inappropriate conduct in relation to Yen LIBOR. RBS Securities Japan Limited is taking steps to address the issues raised in compliance with that order. In June 2013, RBS plc was listed amongst the 20 banks found by the Monetary Authority of Singapore (MAS) to have deficiencies in the governance, risk management, internal controls and surveillance systems relating to benchmark submissions following a finding by the MAS that certain traders made inappropriate attempts to influence benchmarks in the period 2007 - 2011. RBS plc was ordered at that time to set aside additional statutory reserves with MAS of SGD1-1.2 billion and to formulate a remediation plan. RBS plc has submitted its remediation plan to the MAS.

The RBS Group is co-operating with investigations and new and ongoing requests for information by various other governmental and regulatory authorities, including in the UK, US and Asia, into its submissions, communications and procedures relating to a number of trading rates, including LIBOR and other interest rate settings, ISDAFIX and non-deliverable forwards. The RBS Group is also under investigation by competition authorities in a number of jurisdictions stemming from the actions of certain individuals in the setting of LIBOR and other trading rates, as well as interest rate-related trading.

In February 2014, the RBS Group paid settlement penalties of approximately EUR 260 million and EUR 131 million to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements respectively.

In addition, various governmental and regulatory authorities have commenced investigations into foreign exchange trading activities apparently involving multiple financial institutions. The RBS Group has received enquiries from certain of these authorities including the FCA. The RBS Group is reviewing communications and procedures relating to certain currency exchange benchmark rates as well as foreign exchange trading activity. At this stage, the RBS Group cannot estimate reliably what effect, if any, the outcome of the investigation may have on the RBS Group.



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## Notes on the accounts

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### 31 Memorandum items continued

#### Technology incident in June 2012

On 19 June 2012, the RBS Group was affected by a technology incident, as a result of which the processing of certain customer accounts and payments were subject to considerable delay. The cause of the incident has been investigated by independent external counsel with the assistance of third party advisors. The RBS Group agreed to reimburse customers for any loss suffered as a result of the incident and the RBS Group made a provision of £175 million in 2012.

The incident, the RBS Group's handling of the incident, and the systems and controls surrounding the processes affected, are the subject of regulatory investigations in the UK and in the Republic of Ireland.

On 9 April 2013, the UK Financial Conduct Authority (FCA) announced that it had commenced an enforcement investigation into the incident. This is a joint investigation conducted by the FCA together with the UK Prudential Regulation Authority (PRA). The FCA and PRA will reach their conclusions in due course and will decide whether or not to initiate enforcement action following that investigation. While the outcomes of the FCA and PRA investigations will be separate, the regulators have indicated that they will endeavour to co-ordinate the timescales of their respective investigations. Separately the Central Bank of Ireland has initiated an investigation.

#### Interest rate hedging products

In June 2012, following an industry wide review, the FSA announced that the RBS Group and other UK banks had agreed to a redress exercise and past business review in relation to the sale of interest rate hedging products to some small and medium sized businesses who were classified as retail clients or private customers under FSA rules. On 31 January 2013, the FSA issued a report outlining the principles to which it wished the RBS Group and other UK banks to adhere in conducting the review and redress exercise.

The RBS Group will provide fair and reasonable redress to non-sophisticated customers classified as retail clients or private customers, who were mis-sold interest rate hedging products. In relation to non-sophisticated customers classified as retail clients or private customers who were sold interest rate products other than interest rate caps on or after 1 December 2001 up to 29 June 2012, the RBS Group is required to (i) make redress to customers sold structured collars; and (ii) write to customers sold other interest rate hedging products offering a review of their sale and, if it is appropriate in the individual circumstances, the RBS Group will propose fair and reasonable redress on a case by case basis. Furthermore, non-sophisticated customers classified as retail clients or private customers who have purchased interest rate caps during the period on or after 1 December 2001 to 29 June 2012 will be entitled to approach the RBS Group and request a review.

The redress exercise and the past business review are being scrutinised by an independent reviewer, who will review and agree any redress, and will be overseen by the FCA.

In addition to the redress exercise that is being overseen by the FCA, the RBS Group is also dealing with a large number of active claims by customers who are eligible to be considered under the FCA redress programme as well as customers who are outside of such scope due to their sophistication. The RBS Group is encouraging those customers that are eligible, to seek redress under the redress scheme overseen by the FCA. To the extent that claims are brought, the RBS Group believes it has strong grounds for defending these claims.

The RBS Group has decided to undertake a similar exercise and past business review in relation to the sale of interest rate hedging products to retail designated small and medium sized businesses in the Republic of Ireland and to customers of RBS International.

The Group has made provisions totalling £1.25 billion to date for this matter, including £550 million in 2013, of which £0.2 billion has been utilised at 31 December 2013.

#### Retail banking

Since initiating an inquiry into retail banking in the European Union (EU) in 2005, the European Commission (EC) continues to keep retail banking under review. In late 2010 the EC launched an initiative pressing for greater transparency of bank fees and is currently proposing to legislate for increased harmonisation of terminology across Member States. The RBS Group cannot predict the outcome of these actions at this stage.

#### FSA mystery shopping review

On 13 February 2013, the FSA announced the results of a mystery shopping review it undertook into the investment advice offered by banks and building societies to retail clients. As a result of that review the FSA announced that firms involved were cooperative and agreed to take immediate action. The RBS Group was one of the firms involved. The action required includes a review of the training provided to advisers, considering whether changes are necessary to advice processes and controls for new business, and undertaking a past business review to identify any historic poor advice (and where breaches of regulatory requirements are identified, to put this right for customers). The RBS Group will be required to appoint an independent third party to either carry out or oversee this work. The scope and terms of the past business review and the appointment of the independent third party remain under discussion. The RBS Group cannot predict the outcome of this review at this stage.

#### Card Protection Plan Limited

On 22 August 2013, the FCA announced that Card Protection Plan Limited (CPP) and 13 banks and credit card issuers, including the RBS Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. The compensation scheme has now been approved by the requisite number of customers and by the High Court of England and Wales. CPP has written to affected policyholders to ask those who believe they have been mis-sold to submit their claims. Claims that have been submitted to date are currently being processed. Save for exceptional cases, all claims must be submitted before 31 August 2014. The RBS Group has made appropriate levels of provision based on its estimate of ultimate exposure.

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## Notes on the accounts

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### 31 Memorandum items continued

#### Tomlinson Report

On 25 November 2013, a report by Lawrence Tomlinson, entrepreneur in residence at the UK government's Department for Business Innovation and Skills, was published (Tomlinson Report). The Tomlinson Report was critical of the RBS Group's Global Restructuring Group's treatment of SMEs. The Tomlinson Report has been passed to the PRA and FCA. On 29 November 2013, the FCA announced that an independent skilled person will be appointed under Section 166 of the Financial Services and Markets Act to review the allegations in the report. On 17 January 2014, Promontory Financial Group and Mazars were appointed as the skilled person. The RBS Group will fully cooperate with the FCA in its investigation.

In response to the Tomlinson Report, the Bank has instructed Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report: the RBS Group's Global Restructuring Group was alleged to be culpable of systemic and institutional behaviour in artificially distressing otherwise viable businesses and through that putting businesses into insolvency. Clifford Chance is due to submit a report to the RBS Group board by the end of the second quarter of 2014.

#### Multilateral interchange fees

In 2007, the EC issued a decision that, while interchange is not illegal per se, MasterCard's multilateral interchange fee (MIF) arrangements for cross border payment card transactions with MasterCard and Maestro branded consumer credit and debit cards in the EEA were in breach of competition law. MasterCard was required to withdraw (i.e. set to zero) the relevant cross-border MIF by 21 June 2008. MasterCard appealed against the decision to the General Court in March 2008, with the RBS Group intervening in the appeal proceedings. The General Court heard MasterCard's appeal in July 2011 and issued its judgment in May 2012, upholding the EC's original decision. MasterCard has appealed further to the Court of Justice and the RBS Group has intervened in these appeal proceedings. The appeal hearing took place on 4 July 2013 and the Advocate General's (AG) opinion (which is a non binding opinion and provided to the Court in advance of its final decision) was published on 30 January 2014. The AG opinion proposes that the Court should dismiss MasterCard's appeal. The Court's decision is awaited. MasterCard negotiated interim cross border MIF levels to apply for the duration of the General Court proceedings. These MIF levels remain in place during the appeal before the Court of Justice.

On 9 April 2013, the EC announced it was opening a new investigation into interbank fees payable in respect of payments made in the EEA by MasterCard cardholders from non-EEA countries.

In March 2008, the EC opened a formal inquiry into Visa's MIF arrangements for cross border payment card transactions with Visa branded debit and consumer credit cards in the EEA. In April 2009 the EC announced that it had issued Visa with a formal Statement of Objections. In April 2010 Visa announced it had reached an agreement with the EC as regards immediate cross border debit card MIF rates only and in December 2010 the commitments were finalised for a four year period commencing December 2010 under Article 9 of Regulation 1/2003. In July 2012 Visa made a request to re-open the settlement in order to modify the fee. The EC rejected the request and in October 2012 Visa filed an appeal to the General Court seeking to have that decision annulled. That appeal is ongoing. The EC is continuing its investigations into Visa's cross border MIF arrangements for deferred debit and credit transactions. On 31 July 2012 the EC announced that it had issued Visa with a supplementary Statement of Objections regarding consumer credit cards in the EEA. On 14 May 2013, the EC announced it had reached an agreement with Visa regarding immediate cross border credit card MIF rates. This agreement has now been market tested and was made legally binding on 26 February 2014. The agreement is to last for four years.

In addition, the EC has proposed a draft regulation on interchange fees for card payments. The draft regulation is subject to a consultation process, prior to being finalised and enacted. It is currently expected that the regulation will be enacted during early 2015 at the earliest. The draft regulation proposes the capping of both cross-border and domestic MIF rates for debit and credit consumer cards. The draft regulation also sets out other proposals for reform including to the Honour All Cards Rule so merchants will be required to accept all cards with the same level of MIF but not cards with different MIF levels.

In the UK, the Office of Fair Trading (OFT) has ongoing investigations into domestic interchange fees applicable in respect of Visa and MasterCard consumer and commercial credit and debit card transactions. The OFT has not made a finding of an infringement of competition law and has not issued a Statement of Objections to any party in connection with those investigations. In February 2013 the OFT confirmed that while reserving its right to do so, it does not currently expect to issue Statements of Objections in respect of these investigations (if at all) prior to the handing down of the judgment of the Court of Justice in the matter of MasterCard's appeal against the EC's 2007 infringement decision.

The outcomes of these ongoing investigations, proceedings and proposed regulation are not yet known, but they may have a material adverse effect on the structure and operation of four party card payment schemes in general and, therefore, on the RBS Group's business in this sector.

#### Payment Protection Insurance

The FSA conducted a broad industry thematic review of Payment Protection Insurance (PPI) sales practices and in September 2008, the FSA announced that it intended to escalate its level of regulatory intervention. Substantial numbers of customer complaints alleging the mis-selling of PPI policies have been made to banks and to the Financial Ombudsman Service (FOS) and many of these are being upheld by the FOS against the banks.



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## Notes on the accounts

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### 31 Memorandum items continued

The FSA published a final policy statement in August 2010 imposing significant changes with respect to the handling of complaints about the mis-selling of PPI. In October 2010, the British Bankers' Association (BBA) filed an application for judicial review of the FSA's policy statement and of related guidance issued by the FOS. In April 2011 the High Court issued judgment in favour of the FSA and the FOS and in May 2011 the BBA announced that it would not appeal that judgment. The RBS Group then reached agreement with the FSA on a process for implementation of its policy statement and for the future handling of PPI complaints. Implementation of the agreed processes is currently under way. The Group has made provisions totalling £3.1 billion to date for this matter, including £900 million in 2013, of which £2.2 billion has been utilised at 31 December 2013.

#### Personal current accounts / retail banking

In July 2008, the OFT published a market study report into Personal Current Accounts (PCAs) raising concerns as regards the way the market was functioning. In October 2009 the OFT summarised initiatives agreed with industry to address these concerns. In December 2009, the OFT published a further report in which it stated that it continued to have significant concerns about the operation of the PCA market in the UK, in particular in relation to unarranged overdrafts, and that it believed that fundamental changes were required for the market to work in the best interests of bank customers. In March 2010, the OFT announced that it had secured agreement from the banks on four industry-wide initiatives designed to address its concerns, namely minimum standards on the operation of opt-outs from unarranged overdrafts, new working groups on information sharing with customers, best practice for PCA customers in financial difficulties and incurring charges, and PCA providers to publish their policies on dealing with PCA customers in financial difficulties. The OFT also announced that it would conduct six-monthly reviews and would also review the market again fully in 2012 and undertake a brief analysis on barriers to entry.

The first six-monthly review was completed in September 2010. The OFT noted progress in switching, transparency and unarranged overdrafts for the period March to September 2010 and highlighted further changes it wanted to see in the market. In March 2011, the OFT published the next update report in relation to PCAs. This noted further progress in improving consumer control over the use of unarranged overdrafts. In particular, the Lending Standards Board had led on producing standards and guidance to be included in a revised Lending Code. The OFT stated it would continue to monitor the market and would consider the need for, and appropriate timing of, further update reports in light of other developments, in particular the work of the UK Government's Independent Commission on Banking (ICB).

Additionally, in May 2010, the OFT announced its review of barriers to entry. The review concerned retail banking and banking for small and medium size enterprises (SMEs) (up to £25 million turnover). The OFT published its report in November 2010. It advised that it expected its review to be relevant to the ICB, the FSA, HM Treasury and the Department for Business, Innovation and Skills and to the devolved governments in the UK. The OFT did not indicate whether it would undertake any further work. The report maintained that barriers to entry remain, in particular regarding switching, branch networks and brands. At this stage, it is not possible to estimate the effect of the OFT's report and recommendations regarding barriers to entry upon the RBS Group.

On 13 July 2012, the OFT launched its planned full review of the PCA market. The review was intended to consider whether the initiatives agreed by the OFT with banks to date have been successful and whether the market should be referred to the Competition Commission (CC) for a fuller market investigation.

The OFT's PCA report was published on 25 January 2013. The OFT acknowledged some specific improvements in the market since its last review but concluded that further changes are required to tackle ongoing concerns, including a lack of switching, the ability of consumers to compare products and the complexity of overdraft charges. However, the OFT recognised at the time it published the report that a number of major developments were expected over the coming months including divestment of branches, improvements in account switching and assistance to customers to compare products and services. Therefore the OFT decided not to refer the market to the CC but said that it expected to return to the question of a referral to the CC in 2015, or before. The OFT also announced that it will be carrying out behavioural economic research on the way consumers make decisions and engage with retail banking service, and will study the operation of payment systems as well as the SME banking market.

On 11 March 2014, the successor body to the OFT, the Competition and Markets Authority (CMA), announced that in addition to its pending SME review (see below), it intends to carry out a short update of the OFT's 2013 PCA review. The preliminary findings of this update are expected by Summer 2014.

#### SME banking market study

The OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. Following a consultation on the scope of the market study, the OFT published an update paper on 27 September 2013 setting out its proposed scope. On 11 March 2014, the OFT set out some competition concerns on SME banking but also announced that its successor body, the CMA, would continue the review. On the same day, the CMA indicated that it expected to come to a provisional decision on whether or not to refer SME banking to a more detailed phase 2 investigation by Summer 2014.

#### Credit default swaps (CDS) investigation

The RBS Group is a party to the EC's antitrust investigation into the CDS information market. The RBS Group is co-operating fully with the EC's investigation and in July 2013 received a Statement of Objections from the EC. The EC has raised concerns that a number of banks, Markit and ISDA may have jointly prevented exchanges from entering the CDS market. At this stage, the RBS Group cannot estimate reliably what effect the outcome of the investigation may have on the Group, which may be material.

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## Notes on the accounts

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### 31 Memorandum items continued

#### Securitisation and collateralised debt obligation business

In the United States, the RBS Group is involved in reviews, investigations and proceedings (both formal and informal) by federal and state governmental law enforcement and other agencies and self-regulatory organisations relating to, among other things, issuance, underwriting and trading in mortgage-backed securities, collateralised debt obligations (CDOs), and synthetic products. In connection with these inquiries, RBS Group companies have received requests for information and subpoenas seeking information about, among other things, the structuring of CDOs, financing to loan originators, purchase of whole loans, sponsorship and underwriting of securitisations, due diligence, representations and warranties, communications with ratings agencies, disclosure to investors, document deficiencies, trading activities and repurchase requests.

On 7 November 2013, the RBS Group announced that it had settled with the US Securities and Exchange Commission ('the SEC') over its investigation of RBS Securities Inc. relating to due diligence conducted in connection with a 2007 offering of residential mortgage-backed securities and corresponding disclosures. Pursuant to the settlement, RBS Securities Inc., without admitting or denying the SEC's allegations, consented to the entry of a final judgment ordering certain relief, including an injunction and the payment of approximately US\$153 million in disgorgement, penalties, and interest. The settlement was subsequently approved by the United States District Court for the District of Connecticut. The RBS Group co-operated fully with the SEC throughout the investigation.

Also in October 2010, the SEC commenced an inquiry into document deficiencies and repurchase requests with respect to certain securitisations, and in January 2011, this was converted to a formal investigation. Among other matters, the investigation seeks information related to document deficiencies and remedial measures taken with respect to such deficiencies. The investigation also seeks information related to early payment defaults and loan repurchase requests.

In 2007, the New York State Attorney General issued subpoenas to a wide array of participants in the securitisation and securities industry, focusing on the information underwriters obtained from the independent firms hired to perform due diligence on mortgages. The RBS Group completed its production of documents requested by the New York State Attorney General in 2008, principally producing documents related to loans that were pooled into one securitisation transaction. In May 2011, at the New York State Attorney General's request, representatives of the RBS Group attended an informal meeting to provide additional information about the RBS Group's mortgage securitisation business. The investigation is ongoing and the RBS Group continues to provide the requested information.

#### US mortgages - loan repurchase matters

The RBS Group's Markets business in North America has been a purchaser of non-agency US residential mortgages in the secondary market, and an issuer and underwriter of non-agency residential mortgage-backed securities (RMBS). Markets did not originate or service any US residential mortgages and it was not a significant seller of mortgage loans to government sponsored enterprises (GSEs) (e.g. the Federal National Mortgage Association and the Federal Home Loan Mortgage Association).

In issuing RMBS, Markets generally assigned certain representations and warranties regarding the characteristics of the underlying loans made by the originator of the residential mortgages; however, in some circumstances, Markets made such representations and warranties itself. Where Markets has given those or other representations and warranties (whether relating to underlying loans or otherwise), Markets may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of such representations and warranties. In certain instances where it is required to repurchase loans or related securities, Markets may be able to assert claims against third parties who provided representations or warranties to Markets when selling loans to it, although the ability to recover against such parties is uncertain.

Between the start of 2009 and 31 December 2013, Markets received approximately US\$741 million in repurchase demands in respect of loans made primarily from 2005 to 2008 and related securities sold where obligations in respect of contractual representations or warranties were undertaken by Markets. However, repurchase demands presented to Markets are subject to challenge and rebuttal by Markets.

RBS Citizens Financial Group, Inc (RBS Citizens) has not been an issuer or underwriter of non-agency RMBS. However, RBS Citizens is an originator and servicer of residential mortgages, and it routinely sells such mortgage loans in the secondary market and to GSEs. In the context of such sales, RBS Citizens makes certain representations and warranties regarding the characteristics of the underlying loans and, as a result, may be contractually required to repurchase such loans or indemnify certain parties against losses for certain breaches of the representations and warranties concerning the underlying loans. Between the start of 2009 and 31 December 2013, RBS Citizens received US\$208 million in repurchase demands in respect of loans originated primarily since 2003. However, repurchase demands presented to RBS Citizens are subject to challenge and rebuttal by RBS Citizens.

Although there has in recent times been disruption in the ability of certain financial institutions operating in the United States to complete foreclosure proceedings in respect of US mortgage loans in a timely manner or at all (including as a result of interventions by certain states and local governments), to date, RBS Citizens has not been materially impacted by such disruptions and the RBS Group has not ceased making foreclosures.

The RBS Group cannot currently estimate what the ultimate exposure may be with respect to repurchase demands. Furthermore, the RBS Group is unable to estimate the extent to which the matters described above will impact it, and future developments may have an adverse impact on the Group's net assets, operating results or cash flows in any particular period.

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## Notes on the accounts

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### 31 Memorandum items continued

#### RBS Citizens consent orders

The activities of RBS Citizens' two US bank subsidiaries - RBS Citizens, N.A. and Citizens Bank of Pennsylvania - are subject to extensive US laws and regulations concerning unfair or deceptive acts or practices in connection with customer products. Certain of the bank subsidiaries' practices with respect to overdraft protection and other consumer products have not met applicable standards. The bank subsidiaries have implemented and are continuing to implement changes to bring their practices in conformity with applicable laws and regulations. In April 2013, the bank subsidiaries consented to the issuance of orders by their respective primary federal banking regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (the Consent Orders). In the Consent Orders (which are publicly available and will remain in effect until terminated by the regulators), the bank subsidiaries neither admitted nor denied the regulators' findings that they had engaged in deceptive marketing and implementation of the bank's overdraft protection programme, checking rewards programmes, and stop-payment process for pre-authorised recurring electronic fund transfers.

The Consent Orders require the bank subsidiaries to pay a total of US\$10 million in civil monetary penalties, to develop plans to provide restitution to affected customers (the amount of which is anticipated to be approximately US\$8 million), to cease and desist any operations in violation of Section 5 of the Federal Trade Commission Act, and to submit to the regulators periodic written progress reports regarding compliance with the Consent Orders.

In addition, RBS Citizens, N.A. agreed to take certain remedial actions to improve its compliance risk management systems and to create a comprehensive action plan designed to achieve compliance with the Consent Order. Restitution plans have been prepared and submitted for approval, and RBS Citizens, N.A. has submitted for approval and is in the process of implementing its action plan for compliance with the Consent Order, as well as updated policies, procedures and programmes related to its compliance risk management systems. In addition to the above, the bank subsidiaries could face further formal administrative enforcement actions from their federal supervisory agencies, including the assessment of civil monetary penalties and restitution, relating to issues arising from other consumer products.

#### Governance and risk management consent order

On 27 July 2011, the RBS Group agreed with the Board of Governors of the Federal Reserve System, the New York State Banking Department, the Connecticut Department of Banking, and the Illinois Department of Financial and Professional Regulation to enter into a consent Cease and Desist Order (the Order) to address deficiencies related to governance, risk management and compliance systems and controls in RBS plc and RBS N.V. branches. In the Order, the RBS Group agreed to create the following written plans or programmes:

- a plan to strengthen board and senior management oversight of the corporate governance, management, risk management, and operations of the RBS Group's U.S. operations on an enterprise-wide and business line basis,
- an enterprise-wide risk management programme for the RBS Group's U.S. operations,

- a plan to oversee compliance by the RBS Group's U.S. operations with all applicable U.S. laws, rules, regulations, and supervisory guidance,
- a Bank Secrecy Act/anti-money laundering compliance programme for the RBS plc and RBS N.V. branches in the U.S. (the U.S. Branches) on a consolidated basis,
- a plan to improve the U.S. Branches' compliance with all applicable provisions of the Bank Secrecy Act and its rules and regulations as well as the requirements of Regulation K of the Federal Reserve,
- a customer due diligence programme designed to reasonably ensure the identification and timely, accurate, and complete reporting by the U.S. Branches of all known or suspected violations of law or suspicious transactions to law enforcement and supervisory authorities, as required by applicable suspicious activity reporting laws and regulations, and
- a plan designed to enhance the U.S. Branches' compliance with OFAC requirements.

The Order (which is publicly available) identified specific items to be addressed, considered, and included in each proposed plan or programme. The RBS Group also agreed in the Order to adopt and implement the plans and programmes after approval by the regulators, to fully comply with the plans and programmes thereafter, and to submit to the regulators periodic written progress reports regarding compliance with the Order. The RBS Group has created, submitted, and adopted plans and/or programmes to address each of the areas identified above. In connection with the RBS Group's efforts to implement these plans and programmes, it has, among other things, made investments in technology, hired and trained additional personnel, and revised compliance, risk management, and other policies and procedures for the RBS Group's U.S. operations. The RBS Group continues to test the effectiveness of the remediation efforts undertaken by the RBS Group to ensure they are sustainable and meet regulators' expectations. Furthermore, the RBS Group continues to work closely with the regulators in its efforts to fulfil its obligations under the Order, which will remain in effect until terminated by the regulators.

The RBS Group may become subject to formal and informal supervisory actions and may be required by its US banking supervisors to take further actions and implement additional remedial measures with respect to these and additional matters. The RBS Group's activities in the United States may be subject to significant limitations and/or conditions.

#### US dollar processing consent order

The RBS Group's operations include businesses outside the United States that are responsible for processing US dollar payments. On 11 December 2013 RBSG and RBS plc announced that they had reached a settlement with the Board of Governors of the Federal Reserve System (Fed), the New York State Department of Financial Services (DFS), and the Office of Foreign Assets Control (OFAC) with respect to RBS plc's historical compliance with US economic sanction regulations outside the US. In settlement with the above authorities, RBS plc agreed to pay US\$100 million in total, including US\$50 million to the Fed, of which US\$33 million was deemed to satisfy the OFAC penalty, and US\$50 million to DFS.

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## Notes on the accounts

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### 31 Memorandum items continued

As part of the settlement, RBSG and RBS plc entered into a consent Cease and Desist Order with the Fed (the Order) indicating, among other things, that: (a) RBSG and RBS plc lacked adequate risk management and legal review policies and procedures to ensure that activities conducted outside the United States comply with applicable OFAC regulations; (b) from at least 2005 to 2008, certain business lines within RBS plc developed and implemented policies and procedures for processing U.S. dollar-denominated funds transfers through unaffiliated U.S. financial institutions involving parties subject to OFAC Regulations that omitted relevant information from payment messages necessary for the U.S. financial institutions to determine whether these transactions were carried out in a manner consistent with U.S. law; and (c) the RBS Group continues to implement improvements in its oversight and compliance programme for activities involving offices outside the United States that impact the ability of U.S. financial institutions to comply with applicable OFAC sanctions.

In the Order (which is publicly available), the RBS Group agreed to create an OFAC compliance programme to ensure compliance with OFAC regulations by the RBS Group's global business lines outside of the United States, and to adopt, implement, and comply with the programme. The programme has now been submitted to the Federal Reserve Bank of Boston (Reserve Bank) for approval.

Sixty days after approval of the programme, the RBS Group is to complete a global OFAC risk assessment and submit it to the Reserve Bank and the FCA. The RBS Group also agreed in the Order to hire an independent consultant (subject to approval by the Reserve Bank and the FCA) to conduct an annual OFAC compliance review involving a review of compliance policies and their implementation and an appropriate risk-focused sampling of U.S. dollar payments. The Order further requires the RBS Group to submit quarterly written progress reports to the Reserve Bank detailing the form and manner of all actions taken to secure compliance with the Order. It was also announced that the US Department of Justice and the New York County District Attorney's Office had concluded their parallel criminal investigations and do not intend to take any action against RBS plc.

### US/Swiss tax programme

In August 2013, the DOJ announced a programme for Swiss banks (the Programme), to settle the long-running dispute between the US tax authorities and Switzerland regarding the role of Swiss banks in concealing the assets of US tax payers in offshore accounts. The Programme provides Swiss banks with an opportunity to obtain resolution, through non-prosecution agreements or non-target letters, concerning their status in connection with the DOJ's investigations.

Coutts & Co AG (Coutts), a member of the RBS Group incorporated in Switzerland, has notified the DOJ that it intends to participate in the Programme based on the possibility that some of its clients may not have declared their assets in compliance with US tax laws. The Programme requires a detailed review of all US related accounts. The review is due to be completed and the results presented to the DOJ later in 2014.

## Notes on the accounts

### 32 Net cash (outflow)/inflow from operating activities

|                                                                  | Group      |            |            | Bank       |            |            |
|------------------------------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                                                  | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Operating (loss)/profit before tax                               | (6,761)    | (3,524)    | (1,066)    | 8          | (818)      | 1,867      |
| Decrease in prepayments and accrued income                       | 267        | 296        | 700        | 1,755      | 585        | 137        |
| Interest on subordinated liabilities                             | 1,314      | 1,207      | 1,034      | 1,241      | 1,134      | 947        |
| Decrease in accruals and deferred income                         | (634)      | (1,123)    | (1,821)    | (394)      | (658)      | (1,318)    |
| Provisions for impairment losses                                 | 8,449      | 5,214      | 7,176      | 2,536      | 1,548      | 1,533      |
| Loans and advances written-off net of recoveries                 | (3,975)    | (3,555)    | (3,675)    | (1,892)    | (1,823)    | (1,477)    |
| Unwind of discount on impairment losses                          | (389)      | (476)      | (479)      | (112)      | (128)      | (135)      |
| (Profit)/loss on sale of property, plant and equipment           | (45)       | (21)       | (11)       | —          | —          | 7          |
| (Profit)/loss on sale of subsidiaries and associates             | (179)      | (150)      | 67         | (64)       | 174        | (3)        |
| Profit on sale of securities                                     | (1,035)    | (1,803)    | (867)      | (905)      | (1,671)    | (741)      |
| Charge/(credit) for defined benefit pension schemes              | 513        | 512        | 531        | 11         | (3)        | 2          |
| Pension scheme curtailment gains                                 | (3)        | (38)       | —          | (3)        | —          | —          |
| Cash contribution to defined benefit pension schemes             | (817)      | (888)      | (975)      | (41)       | (26)       | (3)        |
| Other provisions charged net of releases                         | 4,407      | 2,853      | 963        | 913        | 1,590      | 417        |
| Other provisions utilised                                        | (2,046)    | (1,496)    | (486)      | (1,103)    | (665)      | (288)      |
| Depreciation and amortisation                                    | 1,272      | 1,614      | 1,590      | 634        | 763        | 613        |
| Gain on redemption of own debt                                   | (162)      | (454)      | (255)      | (77)       | (454)      | —          |
| Write-down of goodwill and other intangible assets               | 423        | 51         | 80         | 227        | 21         | —          |
| Write down/(write back) of investment in subsidiaries            | —          | —          | —          | 86         | (120)      | 40         |
| Elimination of foreign exchange differences                      | 807        | 6,111      | 1,743      | 182        | 4,933      | 2,331      |
| Other non-cash items                                             | (3,193)    | 1,499      | 1,932      | (2,763)    | 2,236      | 1,199      |
| Net cash (outflow)/inflow from trading activities                | (1,787)    | 5,829      | 6,181      | 239        | 6,618      | 5,128      |
| Decrease/(increase) in loans and advances to banks and customers | 56,381     | 15,155     | (5)        | 69,601     | 87,416     | (22,151)   |
| Decrease/(increase) in securities                                | 27,877     | 12,765     | (1,779)    | 15,425     | 7,341      | 1,576      |
| (Increase)/decrease in other assets                              | (800)      | 24,859     | 2,552      | (976)      | 20,570     | 4,065      |
| Decrease/(increase) in derivative assets                         | 155,771    | 89,336     | (97,225)   | 157,032    | 89,089     | (97,891)   |
| Changes in operating assets                                      | 239,229    | 142,115    | (96,457)   | 241,082    | 204,416    | (114,401)  |
| (Decrease)/Increase in deposits by banks and customers           | (88,295)   | 19,116     | 34,932     | (95,704)   | (84,117)   | 47,429     |
| Decrease in debt securities in issue                             | (23,370)   | (64,224)   | (42,618)   | (19,879)   | (49,695)   | (32,597)   |
| Increase/(decrease) in other liabilities                         | 3,660      | (27,075)   | 2,099      | 416        | (23,351)   | (363)      |
| (Decrease)/increase in derivative liabilities                    | (150,145)  | (93,033)   | 99,895     | (150,838)  | (92,985)   | 99,351     |
| (Decrease)/increase in settlement balances and short positions   | (62)       | (13,072)   | (1,496)    | 2,772      | (10,835)   | (2,120)    |
| Changes in operating liabilities                                 | (258,212)  | (178,288)  | 92,812     | (263,233)  | (260,983)  | 111,700    |
| Total income taxes (paid)/received                               | (195)      | (92)       | (98)       | 322        | (84)       | (343)      |
| Net cash (outflow)/inflow from operating activities              | (20,965)   | (30,436)   | 2,438      | (21,590)   | (50,033)   | 2,084      |

## Notes on the accounts

### 33 Analysis of the net investment in business interests and intangible assets

| Acquisitions and disposals                                       | Group      |            |            | Bank       |            |            |
|------------------------------------------------------------------|------------|------------|------------|------------|------------|------------|
|                                                                  | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Fair value given for businesses acquired                         | —          | (60)       | (38)       | —          | (11)       | (129)      |
| Value recognised for business transferred from fellow subsidiary | 3,911      | 8,227      | 7,440      | 4,096      | 8,051      | 7,440      |
| Non-cash consideration                                           | 128        | 706        | —          | 128        | 706        | —          |
| Additional and new investments in Group undertakings             | —          | —          | —          | (2,300)    | (8,287)    | (5,297)    |
| Net inflow of cash in respect of purchases                       | 4,039      | 8,873      | 7,402      | 1,924      | 459        | 2,014      |
| Other assets sold                                                | 785        | 12         | 94         | 260        | 10         | —          |
| Repayment of investments                                         | —          | —          | —          | —          | 206        | 618        |
| Non-cash consideration                                           | 3          | —          | —          | 3          | —          | —          |
| Profit/(loss) on disposal                                        | 179        | 150        | (67)       | 64         | (174)      | 3          |
| Net inflow of cash in respect of disposals                       | 967        | 162        | 27         | 327        | 42         | 621        |
| Dividends received from associates                               | 77         | 18         | 5          | 59         | 2          | 2          |
| Cash expenditure on intangible assets                            | (846)      | (808)      | (918)      | (664)      | (632)      | (570)      |
| Net inflow/(outflow)                                             | 4,237      | 8,245      | 6,516      | 1,646      | (129)      | 2,067      |

### 34 Interest received and paid

|                   | Group      |            |            | Bank       |            |            |
|-------------------|------------|------------|------------|------------|------------|------------|
|                   | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| Interest received | 17,479     | 17,740     | 19,258     | 11,379     | 16,242     | 14,819     |
| Interest paid     | (6,387)    | (6,756)    | (7,481)    | (7,752)    | (10,405)   | (11,064)   |
|                   | 11,092     | 10,984     | 11,777     | 3,627      | 5,837      | 3,755      |

### 35 Analysis of changes in financing during the year

|                                            | Group                                           |            |            |                          |            |            |
|--------------------------------------------|-------------------------------------------------|------------|------------|--------------------------|------------|------------|
|                                            | Share capital, share premium and merger reserve |            |            | Subordinated liabilities |            |            |
|                                            | 2013<br>£m                                      | 2012<br>£m | 2011<br>£m | 2013<br>£m               | 2012<br>£m | 2011<br>£m |
| At 1 January                               | 43,571                                          | 42,865     | 42,865     | 33,851                   | 32,324     | 32,023     |
| Issue of subordinated liabilities          | —                                               | —          | —          | 2,285                    | 2,968      | 940        |
| Repayment of subordinated liabilities      | —                                               | —          | —          | (1,868)                  | (264)      | (624)      |
| Net cash inflow from financing             | —                                               | —          | —          | 417                      | 2,704      | 316        |
| Cross-border merger                        | 128                                             | 706        | —          | —                        | —          | —          |
| Currency translation and other adjustments | —                                               | —          | —          | (1,134)                  | (1,177)    | (15)       |
| At 31 December                             | 43,699                                          | 43,571     | 42,865     | 33,134                   | 33,851     | 32,324     |

|                                            | Bank                                            |            |            |                          |            |            |
|--------------------------------------------|-------------------------------------------------|------------|------------|--------------------------|------------|------------|
|                                            | Share capital, share premium and merger reserve |            |            | Subordinated liabilities |            |            |
|                                            | 2013<br>£m                                      | 2012<br>£m | 2011<br>£m | 2013<br>£m               | 2012<br>£m | 2011<br>£m |
| At 1 January                               | 32,690                                          | 31,984     | 31,984     | 31,635                   | 30,014     | 29,299     |
| Issue of subordinated liabilities          | —                                               | —          | —          | 1,864                    | 2,754      | 940        |
| Repayment of subordinated liabilities      | —                                               | —          | —          | (1,868)                  | —          | (193)      |
| Net cash (outflow)/inflow from financing   | —                                               | —          | —          | (4)                      | 2,754      | 747        |
| Cross-border merger                        | 128                                             | 706        | —          | —                        | —          | —          |
| Currency translation and other adjustments | —                                               | —          | —          | (1,065)                  | (1,133)    | (32)       |
| At 31 December                             | 32,818                                          | 32,690     | 31,984     | 30,566                   | 31,635     | 30,014     |



## Notes on the accounts

### 36 Analysis of cash and cash equivalents

|                                    | Group (1)  |            |            | Bank (2)   |            |            |
|------------------------------------|------------|------------|------------|------------|------------|------------|
|                                    | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2013<br>£m | 2012<br>£m | 2011<br>£m |
| At 1 January                       |            |            |            |            |            |            |
| - cash                             | 86,561     | 97,446     | 88,622     | 83,644     | 86,642     | 79,621     |
| - cash equivalents                 | 46,540     | 38,390     | 40,555     | 42,599     | 38,690     | 34,758     |
|                                    | 133,101    | 135,836    | 129,177    | 126,243    | 125,332    | 114,379    |
| Net cash (outflow)/inflow          | (5,145)    | (2,735)    | 6,659      | (1,615)    | 911        | 10,953     |
| At 31 December                     | 127,956    | 133,101    | 135,836    | 124,628    | 126,243    | 125,332    |
| Comprising:                        |            |            |            |            |            |            |
| Cash and balances at central banks | 79,993     | 74,524     | 68,487     | 75,792     | 70,374     | 64,261     |
| Treasury bills and debt securities | 696        | 756        | 1,148      | 429        | 480        | 677        |
| Loans and advances to banks        | 47,267     | 57,821     | 66,201     | 48,407     | 55,389     | 60,394     |
| Cash and cash equivalents          | 127,956    | 133,101    | 135,836    | 124,628    | 126,243    | 125,332    |

Notes:

(1) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £9,672 million (2012 - £11,553 million; 2011 - £18,030 million).

(2) Includes cash collateral posted with bank counterparties in respect of derivative liabilities of £9,050 million (2012 - £11,545 million; 2011 - £18,021 million).

Certain members of the Group are required by law or regulation to maintain balances with the central banks in the jurisdictions in which they operate. These balances are set out below.

|                       | 2013<br>bn | 2012<br>bn | 2011<br>bn |
|-----------------------|------------|------------|------------|
| Bank of England       | £0.6       | £0.4       | £0.4       |
| US Federal Reserve    | \$1.2      | \$1.2      | \$1.2      |
| De Nederlandsche Bank | €0.1       | €0.2       | —          |

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## Notes on the accounts

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### 37 Segmental analysis

#### (a) Divisions

The directors manage the Group primarily by class of business and present the segmental analysis on that basis. This includes the review of net interest income for each class of business - interest receivable and payable for all reportable segments is therefore presented net. Segments charge market prices for services rendered to other parts of the Group. The segment measure is operating profit/(loss).

In 2013, the Group reclassified certain Business Services allocations across divisions. Comparatives have been restated accordingly; the revision did not affect operating loss.

The Group's reportable segments are on a divisional basis as follows:

*UK Retail* offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile.

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

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

*International Banking* serves the world's largest companies with a leading client proposition focused on financing, risk management and transaction services. It serves as the delivery channel for Markets products to international corporate clients. The division also serves international subsidiaries of clients from other RBS Group divisions (e.g. UK Corporate, Ulster Bank and US Retail & Commercial) through its international network.

*Ulster Bank* is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

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

*Markets* is a leading origination, sales and trading business across debt finance, fixed income and currencies. The division offers a unified service to the Group's corporate and institutional clients. The Markets' origination sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division's trading and structuring teams to meet the client's objectives across financing, risk management, investment, securitisation and liquidity.

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

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



## Notes on the accounts

### 37 Segmental analysis continued

|                                                          | Net<br>interest<br>income<br>£m | Non-interest<br>income<br>£m | Total<br>income<br>£m | Operating<br>expenses<br>£m | Depreciation<br>and<br>amortisation<br>£m | Impairment<br>(losses)/<br>recoveries<br>£m | Operating<br>profit/(loss)<br>£m |
|----------------------------------------------------------|---------------------------------|------------------------------|-----------------------|-----------------------------|-------------------------------------------|---------------------------------------------|----------------------------------|
| <b>2013</b>                                              |                                 |                              |                       |                             |                                           |                                             |                                  |
| UK Retail                                                | 4,057                           | 898                          | 4,955                 | (2,515)                     | —                                         | (324)                                       | 2,116                            |
| UK Corporate                                             | 2,757                           | 1,593                        | 4,350                 | (1,912)                     | (144)                                     | (1,188)                                     | 1,106                            |
| Wealth                                                   | 683                             | 418                          | 1,101                 | (794)                       | (4)                                       | (29)                                        | 274                              |
| International Banking                                    | 725                             | 1,052                        | 1,777                 | (1,120)                     | (4)                                       | (234)                                       | 419                              |
| Ulster Bank                                              | 619                             | 240                          | 859                   | (513)                       | —                                         | (1,774)                                     | (1,428)                          |
| US Retail & Commercial                                   | 1,891                           | 1,073                        | 2,964                 | (1,928)                     | (160)                                     | (156)                                       | 720                              |
| Markets                                                  | (39)                            | 3,072                        | 3,033                 | (2,142)                     | (179)                                     | (26)                                        | 686                              |
| Central items                                            | (600)                           | 329                          | (271)                 | (462)                       | (664)                                     | (64)                                        | (1,461)                          |
| Core                                                     | 10,093                          | 8,675                        | 18,768                | (11,386)                    | (1,155)                                   | (3,795)                                     | 2,432                            |
| Non-Core                                                 | 501                             | 208                          | 709                   | (381)                       | (76)                                      | (4,654)                                     | (4,402)                          |
| Managed basis                                            | 10,594                          | 8,883                        | 19,477                | (11,767)                    | (1,231)                                   | (8,449)                                     | (1,970)                          |
| Reconciling items                                        |                                 |                              |                       |                             |                                           |                                             |                                  |
| Own credit adjustments                                   | —                               | (25)                         | (25)                  | —                           | —                                         | —                                           | (25)                             |
| Payment Protection Insurance costs                       | —                               | —                            | —                     | (900)                       | —                                         | —                                           | (900)                            |
| Interest Rate Hedging Products redress and related costs | —                               | —                            | —                     | (550)                       | —                                         | —                                           | (550)                            |
| Regulatory and legal actions                             | —                               | —                            | —                     | (2,394)                     | —                                         | —                                           | (2,394)                          |
| Integration and restructuring costs                      | —                               | —                            | —                     | (581)                       | (6)                                       | —                                           | (587)                            |
| Gain on redemption of own debt                           | —                               | 162                          | 162                   | —                           | —                                         | —                                           | 162                              |
| Write-down of goodwill and other intangible assets       | —                               | —                            | —                     | (423)                       | —                                         | —                                           | (423)                            |
| Amortisation of purchased intangible assets              | —                               | —                            | —                     | —                           | (35)                                      | —                                           | (35)                             |
| Strategic disposals                                      | —                               | 161                          | 161                   | —                           | —                                         | —                                           | 161                              |
| Bank levy                                                | —                               | —                            | —                     | (200)                       | —                                         | —                                           | (200)                            |
| Statutory basis                                          | 10,594                          | 9,181                        | 19,775                | (16,815)                    | (1,272)                                   | (8,449)                                     | (6,761)                          |
| <b>2012*</b>                                             |                                 |                              |                       |                             |                                           |                                             |                                  |
| UK Retail                                                | 4,084                           | 904                          | 4,988                 | (2,364)                     | —                                         | (529)                                       | 2,095                            |
| UK Corporate                                             | 2,891                           | 1,748                        | 4,639                 | (1,763)                     | (173)                                     | (838)                                       | 1,865                            |
| Wealth                                                   | 740                             | 448                          | 1,188                 | (828)                       | —                                         | (46)                                        | 314                              |
| International Banking                                    | 797                             | 920                          | 1,717                 | (941)                       | —                                         | (131)                                       | 645                              |
| Ulster Bank                                              | 634                             | 196                          | 830                   | (477)                       | —                                         | (1,364)                                     | (1,011)                          |
| US Retail & Commercial                                   | 1,938                           | 1,159                        | 3,097                 | (1,950)                     | (196)                                     | (91)                                        | 860                              |
| Markets                                                  | (273)                           | 4,168                        | 3,895                 | (2,165)                     | (229)                                     | 4                                           | 1,505                            |
| Central items                                            | (1,044)                         | 752                          | (292)                 | (726)                       | (585)                                     | (10)                                        | (1,613)                          |
| Core                                                     | 9,767                           | 10,295                       | 20,062                | (11,214)                    | (1,183)                                   | (3,005)                                     | 4,660                            |
| Non-Core                                                 | 865                             | 870                          | 1,735                 | (469)                       | (248)                                     | (2,209)                                     | (1,191)                          |
| Managed basis                                            | 10,632                          | 11,165                       | 21,797                | (11,683)                    | (1,431)                                   | (5,214)                                     | 3,469                            |
| Reconciling items                                        |                                 |                              |                       |                             |                                           |                                             |                                  |
| Own credit adjustments                                   | —                               | (3,904)                      | (3,904)               | —                           | —                                         | —                                           | (3,904)                          |
| Payment Protection Insurance costs                       | —                               | —                            | —                     | (1,110)                     | —                                         | —                                           | (1,110)                          |
| Interest rate hedging product redress and related costs  | —                               | —                            | —                     | (700)                       | —                                         | —                                           | (700)                            |
| Regulatory and legal actions                             | —                               | —                            | —                     | (381)                       | —                                         | —                                           | (381)                            |
| Integration and restructuring costs                      | —                               | —                            | —                     | (1,084)                     | (142)                                     | —                                           | (1,226)                          |
| Gain on redemption of own debt                           | —                               | 454                          | 454                   | —                           | —                                         | —                                           | 454                              |
| Write-down of goodwill and other intangible assets       | —                               | —                            | —                     | (51)                        | —                                         | —                                           | (51)                             |
| Asset Protection Scheme                                  | —                               | (44)                         | (44)                  | —                           | —                                         | —                                           | (44)                             |
| Amortisation of purchased intangible assets              | —                               | —                            | —                     | —                           | (41)                                      | —                                           | (41)                             |
| Strategic disposals                                      | —                               | 185                          | 185                   | —                           | —                                         | —                                           | 185                              |
| Bank levy                                                | —                               | —                            | —                     | (175)                       | —                                         | —                                           | (175)                            |
| Statutory basis                                          | 10,632                          | 7,856                        | 18,488                | (15,184)                    | (1,614)                                   | (5,214)                                     | (3,524)                          |

\*Restated

## Notes on the accounts

### 37 Segmental analysis continued

| 2011*                                       | Net<br>interest<br>income<br>£m | Non-interest<br>income<br>£m | Total<br>income<br>£m | Operating<br>expenses<br>£m | Depreciation<br>and<br>amortisation<br>£m | Impairment<br>(losses)/<br>recoveries<br>£m | Operating<br>profit/(loss)<br>£m |
|---------------------------------------------|---------------------------------|------------------------------|-----------------------|-----------------------------|-------------------------------------------|---------------------------------------------|----------------------------------|
| UK Retail                                   | 4,320                           | 1,126                        | 5,446                 | (2,504)                     | —                                         | (788)                                       | 2,154                            |
| UK Corporate                                | 2,983                           | 1,770                        | 4,753                 | (1,845)                     | (172)                                     | (792)                                       | 1,944                            |
| Wealth                                      | 645                             | 457                          | 1,102                 | (794)                       | —                                         | (25)                                        | 283                              |
| International Banking                       | 861                             | 1,023                        | 1,884                 | (884)                       | (7)                                       | 16                                          | 1,009                            |
| Ulster Bank                                 | 713                             | 211                          | 924                   | (507)                       | (1)                                       | (1,384)                                     | (968)                            |
| US Retail & Commercial                      | 1,911                           | 1,152                        | 3,063                 | (1,875)                     | (206)                                     | (326)                                       | 656                              |
| Markets                                     | (192)                           | 3,336                        | 3,144                 | (2,355)                     | (181)                                     | (8)                                         | 600                              |
| Central items                               | (1,171)                         | 812                          | (359)                 | (541)                       | (592)                                     | —                                           | (1,492)                          |
| Core                                        | 10,070                          | 9,887                        | 19,957                | (11,305)                    | (1,159)                                   | (3,307)                                     | 4,186                            |
| Non-Core                                    | 1,228                           | 532                          | 1,760                 | (610)                       | (353)                                     | (3,869)                                     | (3,072)                          |
| Managed basis                               | 11,298                          | 10,419                       | 21,717                | (11,915)                    | (1,512)                                   | (7,176)                                     | 1,114                            |
| Reconciling items                           |                                 |                              |                       |                             |                                           |                                             |                                  |
| Own credit adjustments                      | —                               | 797                          | 797                   | —                           | —                                         | —                                           | 797                              |
| Payment Protection Insurance                | —                               | —                            | —                     | (850)                       | —                                         | —                                           | (850)                            |
| Integration and restructuring costs         | —                               | —                            | —                     | (883)                       | (10)                                      | —                                           | (893)                            |
| Gain on redemption of own debt              | —                               | 255                          | 255                   | —                           | —                                         | —                                           | 255                              |
| Asset Protection Scheme                     | —                               | (906)                        | (906)                 | —                           | —                                         | —                                           | (906)                            |
| Amortisation of purchased intangible assets | —                               | —                            | —                     | —                           | (68)                                      | —                                           | (68)                             |
| Strategic disposals                         | —                               | (57)                         | (57)                  | (80)                        | —                                         | —                                           | (137)                            |
| Bonus tax                                   | —                               | —                            | —                     | (78)                        | —                                         | —                                           | (78)                             |
| Bank levy                                   | —                               | —                            | —                     | (300)                       | —                                         | —                                           | (300)                            |
| Statutory basis                             | 11,298                          | 10,508                       | 21,806                | (14,106)                    | (1,590)                                   | (7,176)                                     | (1,066)                          |

|                                | 2013           |                        |             | 2012*          |                        |             | 2011*          |                        |             |
|--------------------------------|----------------|------------------------|-------------|----------------|------------------------|-------------|----------------|------------------------|-------------|
|                                | External<br>£m | Inter<br>segment<br>£m | Total<br>£m | External<br>£m | Inter<br>segment<br>£m | Total<br>£m | External<br>£m | Inter<br>segment<br>£m | Total<br>£m |
| Total revenue                  |                |                        |             |                |                        |             |                |                        |             |
| UK Retail                      | 6,385          | 16                     | 6,401       | 6,498          | 819                    | 7,317       | 6,756          | 409                    | 7,165       |
| UK Corporate                   | 4,557          | 83                     | 4,640       | 4,934          | 119                    | 5,053       | 4,989          | 115                    | 5,104       |
| Wealth                         | 986            | 629                    | 1,615       | 1,059          | 821                    | 1,880       | 1,026          | 729                    | 1,755       |
| International Banking          | 2,002          | 446                    | 2,448       | 1,932          | 473                    | 2,405       | 2,085          | 368                    | 2,453       |
| Ulster Bank                    | 1,021          | 67                     | 1,088       | 1,078          | 99                     | 1,177       | 1,299          | 103                    | 1,402       |
| US Retail & Commercial         | 3,217          | 85                     | 3,302       | 3,426          | 118                    | 3,544       | 3,493          | 185                    | 3,678       |
| Markets                        | 3,933          | 3,988                  | 7,921       | 5,012          | 4,461                  | 9,473       | 4,528          | 4,573                  | 9,101       |
| Central items                  | 2,889          | 7,865                  | 10,754      | 3,098          | 12,828                 | 15,926      | 3,048          | 13,940                 | 16,988      |
| Core                           | 24,990         | 13,179                 | 38,169      | 27,037         | 19,738                 | 46,775      | 27,224         | 20,422                 | 47,646      |
| Non-Core                       | 1,207          | 275                    | 1,482       | 2,647          | 611                    | 3,258       | 3,352          | 198                    | 3,550       |
|                                | 26,197         | 13,454                 | 39,651      | 29,684         | 20,349                 | 50,033      | 30,576         | 20,620                 | 51,196      |
| Eliminations                   | —              | (13,454)               | (13,454)    | —              | (20,349)               | (20,349)    | —              | (20,620)               | (20,620)    |
| Managed basis                  | 26,197         | —                      | 26,197      | 29,684         | —                      | 29,684      | 30,576         | —                      | 30,576      |
| Reconciling items              |                |                        |             |                |                        |             |                |                        |             |
| Own credit adjustments         | (25)           | —                      | (25)        | (3,904)        | —                      | (3,904)     | 797            | —                      | 797         |
| Gain on redemption of own debt | 162            | —                      | 162         | 454            | —                      | 454         | 255            | —                      | 255         |
| Asset Protection Scheme        | —              | —                      | —           | (44)           | —                      | (44)        | (906)          | —                      | (906)       |
| Strategic disposals            | 161            | —                      | 161         | 185            | —                      | 185         | (57)           | —                      | (57)        |
| Statutory basis                | 26,495         | —                      | 26,495      | 26,375         | —                      | 26,375      | 30,665         | —                      | 30,665      |

\*Restated

## Notes on the accounts

### 37 Segmental analysis continued

|                                | 2013           |                        |             | 2012           |                        |             | 2011           |                        |             |
|--------------------------------|----------------|------------------------|-------------|----------------|------------------------|-------------|----------------|------------------------|-------------|
|                                | External<br>£m | Inter<br>segment<br>£m | Total<br>£m | External<br>£m | Inter<br>segment<br>£m | Total<br>£m | External<br>£m | Inter<br>segment<br>£m | Total<br>£m |
| <b>Total income</b>            |                |                        |             |                |                        |             |                |                        |             |
| UK Retail                      | 4,943          | 12                     | 4,955       | 5,118          | (130)                  | 4,988       | 5,484          | (38)                   | 5,446       |
| UK Corporate                   | 4,697          | (347)                  | 4,350       | 5,164          | (525)                  | 4,639       | 5,266          | (513)                  | 4,753       |
| Wealth                         | 617            | 484                    | 1,101       | 537            | 651                    | 1,188       | 495            | 607                    | 1,102       |
| International Banking          | 1,905          | (128)                  | 1,777       | 1,858          | (141)                  | 1,717       | 2,023          | (139)                  | 1,884       |
| Ulster Bank                    | 757            | 102                    | 859         | 774            | 56                     | 830         | 962            | (38)                   | 924         |
| US Retail & Commercial         | 2,888          | 76                     | 2,964       | 2,988          | 109                    | 3,097       | 2,888          | 175                    | 3,063       |
| Markets                        | 2,672          | 361                    | 3,033       | 3,399          | 496                    | 3,895       | 2,733          | 411                    | 3,144       |
| Central items                  | (62)           | (209)                  | (271)       | (431)          | 139                    | (292)       | (944)          | 585                    | (359)       |
| Core                           | 18,417         | 351                    | 18,768      | 19,407         | 655                    | 20,062      | 18,907         | 1,050                  | 19,957      |
| Non-Core                       | 1,060          | (351)                  | 709         | 2,390          | (655)                  | 1,735       | 2,810          | (1,050)                | 1,760       |
| Managed basis                  | 19,477         | —                      | 19,477      | 21,797         | —                      | 21,797      | 21,717         | —                      | 21,717      |
| <b>Reconciling items</b>       |                |                        |             |                |                        |             |                |                        |             |
| Own credit adjustments         | (25)           | —                      | (25)        | (3,904)        | —                      | (3,904)     | 797            | —                      | 797         |
| Gain on redemption of own debt | 162            | —                      | 162         | 454            | —                      | 454         | 255            | —                      | 255         |
| Asset Protection Scheme        | —              | —                      | —           | (44)           | —                      | (44)        | (906)          | —                      | (906)       |
| Strategic disposals            | 161            | —                      | 161         | 185            | —                      | 185         | (57)           | —                      | (57)        |
| Statutory basis                | 19,775         | —                      | 19,775      | 18,488         | —                      | 18,488      | 21,806         | —                      | 21,806      |

|                        | 2013         |                   |                                                                      | 2012         |                   |                                                                      | 2011         |                   |                                                                      |
|------------------------|--------------|-------------------|----------------------------------------------------------------------|--------------|-------------------|----------------------------------------------------------------------|--------------|-------------------|----------------------------------------------------------------------|
|                        | Assets<br>£m | Liabilities<br>£m | Cost to<br>acquire fixed<br>assets and<br>intangible<br>assets<br>£m | Assets<br>£m | Liabilities<br>£m | Cost to<br>acquire fixed<br>assets and<br>intangible<br>assets<br>£m | Assets<br>£m | Liabilities<br>£m | Cost to<br>acquire fixed<br>assets and<br>intangible<br>assets<br>£m |
| <b>Total assets</b>    |              |                   |                                                                      |              |                   |                                                                      |              |                   |                                                                      |
| UK Retail              | 117,514      | 116,262           | —                                                                    | 117,334      | 109,283           | —                                                                    | 114,493      | 104,028           | —                                                                    |
| UK Corporate           | 104,987      | 127,128           | 83                                                                   | 110,167      | 129,643           | 345                                                                  | 114,147      | 129,258           | 712                                                                  |
| Wealth                 | 21,454       | 37,357            | 27                                                                   | 21,482       | 39,338            | 51                                                                   | 21,752       | 39,014            | 65                                                                   |
| International Banking  | 46,284       | 47,193            | 30                                                                   | 49,092       | 49,178            | 24                                                                   | 50,880       | 40,713            | 18                                                                   |
| Ulster Bank            | 28,196       | 27,029            | 11                                                                   | 30,755       | 28,769            | 4                                                                    | 34,812       | 27,792            | 45                                                                   |
| US Retail & Commercial | 71,489       | 61,690            | 267                                                                  | 72,675       | 63,096            | 308                                                                  | 75,840       | 67,377            | 271                                                                  |
| Markets                | 503,090      | 464,718           | 474                                                                  | 725,682      | 697,058           | 320                                                                  | 823,461      | 823,968           | 370                                                                  |
| Central items          | 97,770       | 84,700            | 762                                                                  | 98,614       | 101,244           | 1,063                                                                | 102,465      | 125,453           | 1,902                                                                |
| Core                   | 990,784      | 966,077           | 1,654                                                                | 1,225,801    | 1,217,609         | 2,115                                                                | 1,337,850    | 1,357,603         | 3,383                                                                |
| Non-Core               | 29,150       | 4,992             | 18                                                                   | 58,473       | 7,240             | 169                                                                  | 94,931       | 13,324            | 955                                                                  |
|                        | 1,019,934    | 971,069           | 1,672                                                                | 1,284,274    | 1,224,849         | 2,284                                                                | 1,432,781    | 1,370,927         | 4,338                                                                |

## Notes on the accounts

### 37 Segmental analysis continued

Segmental analysis of assets and liabilities included in disposal groups:

|                        | 2013         |                   | 2012         |                   | 2011         |                   |
|------------------------|--------------|-------------------|--------------|-------------------|--------------|-------------------|
|                        | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m | Assets<br>£m | Liabilities<br>£m |
| UK Retail              | —            | —                 | —            | —                 | 7,048        | 8,808             |
| UK Corporate           | —            | —                 | —            | —                 | 11,728       | 12,976            |
| Wealth                 | 3            | —                 | —            | —                 | —            | —                 |
| US Retail & Commercial | 679          | 3,190             | —            | —                 | —            | —                 |
| Markets                | —            | —                 | —            | —                 | 431          | 117               |
| Centre                 | 1            | —                 | —            | —                 | 127          | —                 |
| Non-Core               | 107          | 20                | 304          | 135               | 4,754        | 939               |
|                        | 790          | 3,210             | 304          | 135               | 24,088       | 22,840            |

Segmental analysis of goodwill is as follows:

|                                            | UK<br>Retail<br>£m | UK<br>Corporate<br>£m | Wealth<br>£m | International<br>Banking<br>£m | US Retail &<br>Commercial<br>£m | Markets<br>£m | Central<br>Items<br>£m | Non-Core<br>£m | Total<br>£m |
|--------------------------------------------|--------------------|-----------------------|--------------|--------------------------------|---------------------------------|---------------|------------------------|----------------|-------------|
| At 1 January 2011                          | 2,790              | 2,882                 | 812          | 220                            | 3,980                           | 2             | 24                     | 15             | 10,725      |
| Transfer to disposal groups                | —                  | —                     | —            | —                              | —                               | —             | —                      | (15)           | (15)        |
| Acquisitions                               | —                  | —                     | —            | —                              | —                               | 18            | —                      | —              | 18          |
| Currency translation and other adjustments | —                  | —                     | —            | 1                              | 12                              | 1             | —                      | —              | 14          |
| Write-down of goodwill                     | (20)               | (60)                  | —            | —                              | —                               | —             | —                      | —              | (80)        |
| At 1 January 2012                          | 2,770              | 2,822                 | 812          | 221                            | 3,992                           | 21            | 24                     | —              | 10,662      |
| Transfer from fellow subsidiaries          | —                  | —                     | —            | 5                              | —                               | —             | —                      | —              | 5           |
| Disposals                                  | —                  | —                     | (9)          | —                              | —                               | —             | (24)                   | —              | (33)        |
| Currency translation and other adjustments | —                  | —                     | (3)          | (2)                            | (169)                           | (1)           | —                      | —              | (175)       |
| Write-down of goodwill                     | —                  | —                     | —            | (18)                           | —                               | (18)          | —                      | —              | (36)        |
| At 1 January 2013                          | 2,770              | 2,822                 | 800          | 206                            | 3,823                           | 2             | —                      | —              | 10,423      |
| Disposals                                  | —                  | —                     | (1)          | —                              | —                               | —             | —                      | —              | (1)         |
| Currency translation and other adjustments | —                  | —                     | 2            | 2                              | (88)                            | —             | —                      | —              | (84)        |
| Write-down of goodwill                     | —                  | —                     | —            | (208)                          | —                               | —             | —                      | —              | (208)       |
| At 31 December 2013                        | 2,770              | 2,822                 | 801          | —                              | 3,735                           | 2             | —                      | —              | 10,130      |

## Notes on the accounts

### 37 Segmental analysis continued

#### (b) Geographical segments

The geographical analysis in the tables below has been compiled on the basis of location of office where the transactions are recorded.

| 2013                                                                         | UK<br>£m | USA<br>£m | Europe<br>£m | Rest of<br>the World<br>£m | Total<br>£m |
|------------------------------------------------------------------------------|----------|-----------|--------------|----------------------------|-------------|
| Total revenue                                                                | 16,541   | 5,426     | 3,208        | 1,320                      | 26,495      |
| Net interest income                                                          | 7,531    | 2,212     | 790          | 61                         | 10,594      |
| Net fees and commissions                                                     | 2,484    | 1,088     | 729          | 168                        | 4,469       |
| Income from trading activities                                               | 1,583    | 999       | 199          | 193                        | 2,974       |
| Other operating income                                                       | 792      | 341       | 605          | —                          | 1,738       |
| Total income                                                                 | 12,390   | 4,640     | 2,323        | 422                        | 19,775      |
| Operating (loss)/profit before tax                                           | (2,356)  | (581)     | (3,706)      | (118)                      | (6,761)     |
| Total assets                                                                 | 731,360  | 199,305   | 51,763       | 37,506                     | 1,019,934   |
| Of which assets held for sale                                                | —        | 750       | 38           | 2                          | 790         |
| Total liabilities                                                            | 703,711  | 184,286   | 46,139       | 36,933                     | 971,069     |
| Of which liabilities held for sale                                           | —        | 3,210     | —            | —                          | 3,210       |
| Net assets attributable to equity shareholders and non-controlling interests | 27,649   | 15,019    | 5,624        | 573                        | 48,865      |
| Contingent liabilities and commitments                                       | 108,274  | 82,758    | 40,961       | 5,095                      | 237,088     |
| Cost to acquire property, plant and equipment and intangible assets          | 1,035    | 412       | 217          | 8                          | 1,672       |
| 2012*                                                                        |          |           |              |                            |             |
| Total revenue                                                                | 14,889   | 6,272     | 3,095        | 2,119                      | 26,375      |
| Net interest income                                                          | 7,757    | 2,252     | 631          | (8)                        | 10,632      |
| Net fees and commissions                                                     | 2,788    | 1,192     | 470          | 145                        | 4,595       |
| Income from trading activities                                               | (394)    | 1,538     | 151          | 216                        | 1,511       |
| Other operating income                                                       | 991      | 247       | 499          | 13                         | 1,750       |
| Total income                                                                 | 11,142   | 5,229     | 1,751        | 366                        | 18,488      |
| Operating profit/(loss) before tax                                           | (3,597)  | 1,902     | (1,540)      | (289)                      | (3,524)     |
| Total assets                                                                 | 867,353  | 298,593   | 63,992       | 54,336                     | 1,284,274   |
| Of which assets held for sale                                                | —        | 304       | —            | —                          | 304         |
| Total liabilities                                                            | 837,135  | 281,304   | 52,561       | 53,849                     | 1,224,849   |
| Of which liabilities held for sale                                           | —        | 135       | —            | —                          | 135         |
| Net assets attributable to equity shareholders and non-controlling interests | 30,218   | 17,289    | 11,431       | 487                        | 59,425      |
| Contingent liabilities and commitments                                       | 108,437  | 80,553    | 44,769       | 5,152                      | 238,911     |
| Cost to acquire property, plant and equipment and intangible assets          | 1,770    | 325       | 161          | 28                         | 2,284       |
| 2011*                                                                        |          |           |              |                            |             |
| Total revenue                                                                | 17,995   | 6,516     | 3,655        | 2,499                      | 30,665      |
| Net interest income                                                          | 7,727    | 2,336     | 1,112        | 123                        | 11,298      |
| Net fees and commissions                                                     | 3,059    | 1,331     | 329          | 132                        | 4,851       |
| Income from trading activities                                               | 385      | 1,318     | 297          | 14                         | 2,014       |
| Other operating income                                                       | 2,664    | 192       | 803          | (16)                       | 3,643       |
| Total income                                                                 | 13,835   | 5,177     | 2,541        | 253                        | 21,806      |
| Operating (loss)/profit before tax                                           | (559)    | 1,748     | (1,781)      | (474)                      | (1,066)     |
| Total assets                                                                 | 979,164  | 349,206   | 44,146       | 60,265                     | 1,432,781   |
| Of which assets held for sale                                                | 19,332   | 53        | 4,660        | 43                         | 24,088      |
| Total liabilities                                                            | 946,864  | 331,976   | 32,311       | 59,776                     | 1,370,927   |
| Of which liabilities held for sale                                           | 21,903   | 104       | 833          | —                          | 22,840      |
| Net assets attributable to equity shareholders and non-controlling interests | 32,300   | 17,230    | 11,835       | 489                        | 61,854      |
| Contingent liabilities and commitments                                       | 123,886  | 90,305    | 27,980       | 5,945                      | 248,116     |
| Cost to acquire property, plant and equipment and intangible assets          | 2,409    | 499       | 1,393        | 37                         | 4,338       |

\*Restated

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## Notes on the accounts

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### 38 Directors' and key management remuneration

The directors of the Bank are also directors of the holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

#### Compensation of key management

The aggregate remuneration of directors and other members of key management during the year, borne by the RBS Group, was as follows:

|                          | 2013<br>£000  | 2012<br>£000  |
|--------------------------|---------------|---------------|
| Short-term benefits      | 30,590        | 32,540        |
| Post-employment benefits | 238           | 699           |
| Termination benefits     | 2,033         | —             |
| Share-based payments     | 13,003        | 24,533        |
|                          | <u>45,864</u> | <u>57,772</u> |

### 39 Transactions with directors and key management

(a) At 31 December 2013, amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £850,762 in respect of loans to seven persons who were directors of the company at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of the Group Management Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

|                                 | 2013<br>£000 | 2012<br>£000 |
|---------------------------------|--------------|--------------|
| Loans and advances to customers | 10,750       | 11,748       |
| Customer accounts               | 33,279       | 36,250       |

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the holding company.

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## Notes on the accounts

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### 40 Related parties

#### UK Government

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

The Group enters into transactions with many of these bodies on an arm's length basis. The principal transactions during 2013, 2012 and 2011 were: Bank of England facilities and the issue of debt guaranteed by the UK Government discussed below and the Asset Protection Scheme which the Group exited on 18 October 2012 having paid total premiums of £2.5 billion. Other transactions include the payment of: taxes principally UK corporation tax (page 231) and value added tax; national insurance contributions; local authority rates; and regulatory fees and levies (including the bank levy (page 222) and FSCS levies (page 306)); together with banking transactions such as loans and deposits undertaken in the normal course of banker-customer relationships.

#### Bank of England facilities

The Group also participates in a number of schemes operated by the Bank of England available to eligible banks and building societies.

- Open market operations - these provide market participants with funding at market rates on a tender basis in the form of short and long-term repos on a wide range of collateral and outright purchases of high-quality bonds to enable them to meet the reserves that they must hold at the Bank of England.
- The special liquidity scheme - this was launched in April 2008 to allow financial institutions to swap temporarily illiquid assets for treasury bills, with fees charged based on the spread between 3-month LIBOR and the 3-month gilt repo rate. The scheme officially closed on 30 January 2012.

At 31 December 2013, the Group had no amounts outstanding under these facilities (2012 and 2011 - nil).

Members of the Group that are UK authorised institutions are required to maintain non-interest bearing (cash ratio) deposits with the Bank of England amounting to 0.11% of their eligible liabilities. They also have access to Bank of England reserve accounts: sterling current accounts that earn interest at the Bank of England Rate.

#### Government credit and asset-backed securities guarantee schemes

These schemes guarantee eligible debt issued by qualifying institutions for a fee. The fee, payable to HM Treasury is based on a per annum rate of 25 (asset-backed securities guarantee scheme) and 50 (credit guarantee scheme) basis points plus 100% of the institution's median five-year credit default swap spread during the twelve months to 1 July 2008. The asset-backed securities scheme closed to new issuance on 31 December 2009 and the credit guarantee scheme on 28 February 2010.

At 31 December 2013, the Group had no debt outstanding guaranteed by the Government (2012 - nil; 2011 - £21.3 billion).

#### National Loan Guarantee Scheme

The Group participated in the National Loan Guarantee Scheme (NLGS), providing loans and facilities to eligible customers at a discount of one percent. It did not issue any guaranteed debt under the scheme and consequently, it was not committed to providing a particular volume of reduced rate facilities. At 31 December 2013 the Group had no amounts outstanding under the scheme (2012 - £898 million). The NLGS was superseded by the Funding for Lending Scheme.

#### The Funding for Lending Scheme

The Funding for Lending Scheme was launched in July 2012. Under the scheme UK banks and building societies are able to borrow UK treasury bills from the Bank of England in exchange for eligible collateral during the drawdown period (1 August 2012 to 31 January 2014). Borrowing is limited to 5% of the participant's stock of loans to the UK non-financial sector as at 30 June 2012, plus any expansion in lending from that date to the end of 2013. Eligible collateral comprises all collateral eligible for the Bank of England's discount window facility. The term of each transaction is four years from the date of drawdown. The price for borrowing UK treasury bills under the scheme depends on the participant's net lending to the UK non-financial sector between 30 June 2012 and the end of 2013. If lending is maintained or expanded over that period, the fee is 0.25% per year on the amount borrowed. If lending declines, the fee increases by 0.25% for each 1% fall in lending, up to a maximum fee of 1.5%. As at 31 December 2013 the Group had no amounts outstanding under the scheme (2012 - £749 million).

#### Other related parties

- (a) In their roles as providers of finance, Group companies provide development and other types of capital support to businesses. These investments are made in the normal course of business and on arm's length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.
- (b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.
- (c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.
- (d) The captions in the primary financial statements of the Bank include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements. The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

## Notes on the accounts

|                                 | 2013<br>£m | 2012<br>£m | 2011<br>£m |
|---------------------------------|------------|------------|------------|
| <b>Income</b>                   |            |            |            |
| Interest receivable             | 158        | 163        | 122        |
| Interest payable                | 1,023      | 930        | 896        |
| Fees and commissions receivable | 22         | 179        | 109        |
| Fees and commissions payable    | 79         | 99         | 108        |
| <b>Expenses</b>                 |            |            |            |
| Premises and equipment          | —          | 3          | 7          |

### 41 Ultimate holding company

The Group's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. As at 31 December 2013, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

Following placing and open offers by The Royal Bank of Scotland Group plc in December 2008 and April 2009, the UK Government, through HM Treasury, currently holds 63.9% of the issued ordinary share capital of the holding company and is therefore the Group's ultimate controlling party.

### 42 Post balance sheet events

#### RBS Capital Resolution

In November 2013, RBS Group announced the creation of RBS Capital Resolution (RCR), to manage a pool of assets with particularly high long term capital intensity and/or potentially volatile outcomes in stressed environments. RCR became operational on 1 January 2014 with a portfolio of £29 billion assets, of which £27.3 billion related to the Group.

#### Sale of selected Chicago-area operations of RBS Citizens

On 7 January 2014, RBS Group announced that RBS Citizens Financial Group, Inc. had reached agreement to sell its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, a subsidiary U.S. Bancorp. The sale includes 94 Charter One branches in the Chicago area, \$5.3 billion in local deposits and \$1.1 billion in locally originated loans for a deposit premium of approximately \$315 million, or 6 percent of deposits. The transaction is subject to regulatory approval and is anticipated to close in mid-2014.

### Disposal of Structured Retail Investor Products and Equity Derivatives Businesses

On 19 February 2014, RBS Group announced that it had reached agreement with BNP Paribas S.A. for the disposal of assets and liabilities related to its structured retail investor products and equity derivatives businesses, and associated market-making activities. The disposal is subject to competition approval and will be implemented on a phased basis during 2014 and 2015. The consideration is not material.

### Strategic review

In November 2013, RBS Group announced that it was undertaking a comprehensive business review of its customer-facing businesses, IT and operations and organisational and decision making structures.

On 27 February 2014, RBS Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved resilience.

Other than as detailed above, there have been no significant events between 31 December 2013 and the date of approval of this announcement which would require a change to or additional disclosure in the accounts.



## Additional information

### Five year summary

| Summary consolidated income statement | 2013<br>£m | 2012*<br>£m | 2011*<br>£m | 2010*<br>£m | 2009*<br>£m |
|---------------------------------------|------------|-------------|-------------|-------------|-------------|
| Net interest income                   | 10,594     | 10,632      | 11,298      | 12,111      | 11,543      |
| Non-interest income (1,2,3)           | 9,181      | 7,856       | 10,508      | 11,593      | 13,000      |
| Total income                          | 19,775     | 18,488      | 21,806      | 23,704      | 24,543      |
| Operating expenses (4,5,6,7,8)        | (18,087)   | (16,798)    | (15,696)    | (14,617)    | (12,466)    |
| Profit before impairment losses       | 1,688      | 1,690       | 6,110       | 9,087       | 12,077      |
| Impairment losses                     | (8,449)    | (5,214)     | (7,176)     | (9,400)     | (12,174)    |
| Operating loss before tax             | (6,761)    | (3,524)     | (1,066)     | (313)       | (97)        |
| Tax (charge)/credit                   | (503)      | (336)       | (680)       | (675)       | 549         |
| (Loss)/profit for the year            | (7,264)    | (3,860)     | (1,746)     | (988)       | 452         |

#### Loss attributable to:

|                             |         |         |         |         |       |
|-----------------------------|---------|---------|---------|---------|-------|
| Non-controlling interests   | (13)    | 19      | (8)     | 29      | 235   |
| Preference shareholders     | 58      | 58      | 58      | 60      | 523   |
| Ordinary and B shareholders | (7,309) | (3,937) | (1,796) | (1,077) | (306) |

\* Restated

#### Notes:

- (1) Includes profit on strategic disposals of £161 million (2012 - £185 million profit; 2011 - £57 million loss; 2010 - £645 million profit; 2009 - nil).
- (2) Includes gain on redemption of own debt of £162 million (2012 - £454 million; 2011 - £255 million; 2010 - £502 million).
- (3) Includes own credit adjustments of £25 million loss (2012 - £3,904 million loss; 2011 - £797 million gain; 2010 - £3 million loss; 2009 - £298 million loss).
- (4) Includes Payment Protection Insurance costs of £900 million (2012 - £1,110 million; 2011 - £850 million), Interest Rate Hedging Products redress and related costs of £550 million (2012 - £700 million) and regulatory and legal actions of £2,394 million (2012 - £381 million).
- (5) Includes integration and restructuring costs of £587 million (2012 - £1,226 million; 2011 - £893 million; 2010 - £825 million; 2009 - £859 million).
- (6) Includes amortisation of purchased intangibles of £35 million (2012 - £41 million; 2011 - £68 million; 2010 - £63 million; 2009 - £81 million).
- (7) Includes write-down of goodwill and other intangible assets of £423 million (2012 - £51 million; 2011 - £80 million; 2010 - £1 million; 2009 - £118 million).
- (8) Includes gains on pensions curtailment of £2,148 million in 2009.

| Summary consolidated balance sheet                   | 2013<br>£m | 2012<br>£m | 2011<br>£m | 2010<br>£m | 2009<br>£m |
|------------------------------------------------------|------------|------------|------------|------------|------------|
| Loans and advances                                   | 505,583    | 576,904    | 586,539    | 605,826    | 604,610    |
| Debt securities and equity shares                    | 108,974    | 150,457    | 180,903    | 168,369    | 187,586    |
| Derivatives and settlement balances                  | 295,037    | 450,818    | 539,709    | 437,753    | 455,506    |
| Other assets                                         | 110,340    | 106,095    | 125,630    | 95,382     | 85,279     |
| Total assets                                         | 1,019,934  | 1,284,274  | 1,432,781  | 1,307,330  | 1,332,981  |
| Owners' equity                                       | 48,786     | 59,288     | 61,726     | 57,010     | 55,051     |
| Non-controlling interests                            | 79         | 137        | 128        | 597        | 1,146      |
| Subordinated liabilities                             | 33,134     | 33,851     | 32,324     | 32,023     | 34,717     |
| Deposits                                             | 537,467    | 621,457    | 581,485    | 557,545    | 569,440    |
| Derivatives, settlement balances and short positions | 319,382    | 469,458    | 575,060    | 470,600    | 468,938    |
| Other liabilities                                    | 81,086     | 100,083    | 182,058    | 189,555    | 203,689    |
| Total liabilities and equity                         | 1,019,934  | 1,284,274  | 1,432,781  | 1,307,330  | 1,332,981  |

## Additional information

### Other contractual cash obligations

The table below summarises the Group's other contractual cash obligations by payment date.

|                                                       | Group            |                   |                 |                 |                  |                   |
|-------------------------------------------------------|------------------|-------------------|-----------------|-----------------|------------------|-------------------|
|                                                       | 0-3 months<br>£m | 3-12 months<br>£m | 1-3 years<br>£m | 3-5 years<br>£m | 5-10 years<br>£m | 10-20 years<br>£m |
| 2013                                                  |                  |                   |                 |                 |                  |                   |
| Operating leases                                      | 90               | 258               | 630             | 513             | 786              | 1,358             |
| Contractual obligations to purchase goods or services | 107              | 266               | 189             | 588             | 12               | —                 |
|                                                       | 197              | 524               | 819             | 1,101           | 798              | 1,358             |
| 2012                                                  |                  |                   |                 |                 |                  |                   |
| Operating leases                                      | 207              | 168               | 667             | 546             | 886              | 1,375             |
| Contractual obligations to purchase goods or services | 110              | 334               | 500             | 15              | —                | —                 |
|                                                       | 317              | 502               | 1,167           | 561             | 886              | 1,375             |
|                                                       | Bank             |                   |                 |                 |                  |                   |
|                                                       | 0-3 months<br>£m | 3-12 months<br>£m | 1-3 years<br>£m | 3-5 years<br>£m | 5-10 years<br>£m | 10-20 years<br>£m |
| 2013                                                  |                  |                   |                 |                 |                  |                   |
| Operating leases                                      | 38               | 110               | 275             | 249             | 487              | 901               |
| Contractual obligations to purchase goods or services | 104              | 230               | 185             | 581             | 12               | —                 |
|                                                       | 142              | 340               | 460             | 830             | 499              | 901               |
| 2012                                                  |                  |                   |                 |                 |                  |                   |
| Operating leases                                      | 153              | 8                 | 295             | 252             | 540              | 879               |
| Contractual obligations to purchase goods or services | 108              | 278               | 494             | 15              | —                | —                 |
|                                                       | 261              | 286               | 789             | 267             | 540              | 879               |

## Additional information

### Cross border exposures

Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

The Group monitors the geographical breakdown of these exposures based on the country of domicile of the borrower or guarantor of ultimate risk. Cross border exposures exclude exposures to local residents in local currencies.

The table below sets out the Group's cross border exposures greater than 0.5% of the Group's total assets. None of these countries have experienced repayment difficulties that have required restructuring of outstanding debt.

|                     | Government<br>£m | Banks<br>£m | Other<br>£m | Total<br>£m | Short positions<br>£m | Net of short<br>positions<br>£m |
|---------------------|------------------|-------------|-------------|-------------|-----------------------|---------------------------------|
| <b>2013</b>         |                  |             |             |             |                       |                                 |
| United States       | 7,592            | 1,917       | 24,354      | 33,863      | 7,984                 | 25,879                          |
| Germany             | 11,975           | 2,521       | 4,802       | 19,298      | 4,440                 | 14,858                          |
| France              | 4,432            | 10,033      | 4,182       | 18,647      | 2,352                 | 16,295                          |
| Netherlands         | 4,979            | 1,548       | 5,927       | 12,454      | 1,192                 | 11,262                          |
| Spain               | 1,417            | 2,813       | 3,486       | 7,716       | 801                   | 6,915                           |
| Japan               | 34               | 4,866       | 1,876       | 6,776       | 2,556                 | 4,220                           |
| Italy               | 4,922            | 635         | 1,089       | 6,646       | 3,302                 | 3,344                           |
| Republic of Ireland | 30               | 2,554       | 2,698       | 5,282       | 51                    | 5,231                           |
| <b>2012</b>         |                  |             |             |             |                       |                                 |
| United States       | 17,411           | 1,331       | 30,713      | 49,455      | 12,080                | 37,375                          |
| France              | 6,132            | 13,029      | 5,616       | 24,777      | 2,156                 | 22,621                          |
| Germany             | 13,198           | 3,594       | 6,696       | 23,488      | 1,955                 | 21,533                          |
| Netherlands         | 5,350            | 2,077       | 10,700      | 18,127      | 1,123                 | 17,004                          |
| Japan               | 4,338            | 6,822       | 1,409       | 12,569      | 2,326                 | 10,243                          |
| Spain               | 857              | 1,490       | 4,652       | 6,999       | 514                   | 6,485                           |
| Republic of Ireland | 89               | 3,384       | 2,982       | 6,455       | 59                    | 6,396                           |
| Italy               | 3,359            | 247         | 1,099       | 4,705       | 2,301                 | 2,404                           |
| <b>2011</b>         |                  |             |             |             |                       |                                 |
| United States       | 17,933           | 6,668       | 30,574      | 55,175      | 13,329                | 41,846                          |
| France              | 10,263           | 14,276      | 7,093       | 31,632      | 5,904                 | 25,728                          |
| Germany             | 30,766           | 4,457       | 9,370       | 44,593      | 2,947                 | 41,646                          |
| Netherlands         | 4,466            | 1,921       | 9,124       | 15,511      | 910                   | 14,601                          |
| Japan               | 8,349            | 7,423       | 3,330       | 19,102      | 3,141                 | 15,961                          |
| Spain               | 308              | 1,245       | 6,153       | 7,706       | 973                   | 6,733                           |
| Republic of Ireland | 26               | 3,649       | 2,566       | 6,241       | 68                    | 6,173                           |
| Italy               | 4,495            | 526         | 1,199       | 6,220       | 4,823                 | 1,397                           |

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## Additional information

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### Risk factors

Set out below are certain risk factors which could adversely affect the RBS Group's future results, its financial condition and prospects and cause them to be materially different from what is expected. The factors discussed below and elsewhere in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties facing the RBS Group.

RBS plc is a principal operating subsidiary of RBSG and accounts for a substantial proportion of the consolidated assets, liabilities and operating profits of RBSG. Accordingly, risk factors below which relate to RBSG and the RBS Group will also be of relevance to the Bank and the Group.

The RBS Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of the RBS Group's plans to refocus on its core strengths and the timely divestment of RBS Citizens. Since the beginning of the global economic and financial crisis in 2008 and as a result of the changed global economic outlook, the RBS Group has been engaged in a financial and core business restructuring which has been focused on achieving appropriate risk-adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital-intensive businesses. A key part of the restructuring programme announced in February 2009 was to run down and sell the RBS Group's non-core assets and businesses with a continued review of the RBS Group's portfolio to identify further disposals of certain non-core assets and businesses. Assets identified for this purpose and allocated to the RBS Group's Non-Core division totalled £258 billion, excluding derivatives, at 31 December 2008. By 31 December 2013, this total had reduced to £28.0 billion (31 December 2012 - £57.4 billion), excluding derivatives, as further progress was made in business disposals and portfolio sales during the course of 2013. This balance sheet reduction programme has been implemented alongside the disposals under the State Aid restructuring plan approved by the EC. During 2012 the RBS Group implemented changes to its wholesale banking operations, including the reorganisation of its wholesale businesses and the exit and downsizing of selected existing activities (including cash equities, corporate banking, equity capital markets, and mergers and acquisitions).

During Q3 2013, the RBS Group worked with HM Treasury as part of its assessment of the merits of creating an external "bad bank" to hold certain assets of the RBS Group. Although the review concluded that the establishment of an external "bad bank" was not in the best interests of all stakeholders, the RBS Group committed to take a series of actions to further de-risk its business and strengthen its capital position.

These actions include:

- The formation of the Capital Resolution Group (CRG), which is made up of four pillars: exiting the assets in RBS Capital Resolution (RCR), delivering the initial public offerings (IPO) for both RBS Citizens and Williams & Glyn and optimising the RBS Group's shipping business;
- The creation of RCR to manage the run-down of problem assets, which totalled £29 billion at the end of 2013, with the goal of removing 55-70% of these assets over the next two years with a clear aspiration to remove all these assets from the balance sheet in three years; and
- Lifting the RBS Group's capital targets including by:
  - accelerating the divestment of RBS Citizens, the RBS Group's US banking subsidiary, with a partial IPO now planned for 2014, and full divestment of the business intended by the end of 2016; and
  - intensifying management actions to reduce risk weighted assets.

Since the end of Q3 2013, the RBS Group has been conducting a review of its activities which has resulted in additional changes to the RBS Group's strategic goals. It is now intended to further simplify and downsize the RBS Group with an increased focus on service to its customers. As part of simplifying the RBS Group, the current divisional structure will be replaced by three new customer segments, covering Personal & Business, Commercial & Private Banking and Corporate & Institutional Banking. As part of this reorganisation of the business, the intention will be to remain in businesses where the RBS Group can be number one for its customers. For those businesses where that is not the case, the RBS Group will either fix, close or dispose of such businesses. This reorganisation, together with investment in technology and more efficient support functions are intended to deliver significant improvements in the RBS Group's Return on Equity and cost:income ratio in the longer term.

Implementation of the RBS Group's new strategic plan will require significant restructuring of the RBS Group at the same time that it will also be implementing structural changes to comply with the Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act" 2013) and its ring-fencing requirements. The level of structural change intended to be implemented within the RBS Group over the medium term taken together with the overall scale of change to make the RBS Group a smaller, more focused financial institution, are likely to be disruptive and increase operational risks for the RBS Group. There can be no assurance that the RBS Group will be able to successfully implement this new strategy together with other changes required of the RBS Group in the time frames contemplated or at all.

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## Additional information

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### Risk factors continued

The RBS Group's ability to dispose of businesses, including RBS Citizens and the EC mandated branch divestment now known as Williams & Glyn, and assets and the price achieved for such disposals will be dependent on prevailing economic and market conditions, which remain volatile: As a result there is no assurance that the RBS Group will be able to sell or run down (as applicable) the businesses it has planned to sell or exit or asset portfolios it is seeking to sell either on favourable economic terms to the RBS Group or at all. Material tax or other contingent liabilities could arise on the disposal or run-down of assets or businesses and there is no assurance that any conditions precedent agreed will be satisfied, or consents and approvals required will be obtained in a timely manner, or at all. There is consequently a risk that the RBS Group may fail to complete such disposals within time frames envisaged by the RBS Group, its regulators and the EC.

The RBS Group may be exposed to deteriorations in businesses or portfolios being sold between the announcement of the disposal and its completion, which period may be lengthy and may span many months. In addition, the RBS Group may be exposed to certain risks, including risks arising out of ongoing liabilities and obligations, breaches of covenants, representations and warranties, indemnity claims, transitional services arrangements and redundancy or other transaction related costs.

The occurrence of any of the risks described above could negatively affect the RBS Group's ability to implement its new strategic plan and achieve its capital targets and could have a material adverse effect on the RBS Group's business, results of operations, financial condition and cash flows. There can also be no assurance that if the RBS Group is able to execute its strategic plan that the new strategy will ultimately be successful or beneficial to the RBS Group.

### The RBS Group is subject to political risks

The RBS Group and The Royal Bank of Scotland plc ("RBS" or the "Royal Bank"), its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of such referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the RBS Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the RBS Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the EU. The occurrence of any of the impacts above could significantly impact the RBS Group's costs and would have a material adverse effect on the RBS Group's business, financial condition, results of operations and prospects.

### The RBS Group is subject to a number of legal, regulatory and governmental actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on the RBS Group's operating results or reputation

The RBS Group's operations are diverse and complex, and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory and governmental investigations and other regulatory risk. As a result, the RBS Group has recently settled a number of legal and regulatory investigations and is, and may in the future be, involved in a number of legal and regulatory proceedings and investigations in the UK, the EU, the US and other jurisdictions.

The RBS Group is involved in ongoing class action litigation, investigations into foreign exchange trading and rate setting activities, continuing LIBOR related litigation and investigations, securitisation and securities related litigation, and anti-money laundering, sanctions, mis-selling and compliance related investigations, in addition to a number of other matters. In respect of the LIBOR and other trading rate-related investigations, the RBS Group reached settlements on 6 February 2013 with the Financial Services Authority, the Commodity Futures Trading Association and the United States Department of Justice and on 4 December 2013 with the EC. In addition, the RBS Group and the Royal Bank reached a settlement with the Board of Governors of the Federal Reserve System, the New York State Department of Financial Services and the Office of Foreign Assets Control with respect to the Royal Bank's historical compliance with US economic sanction regulations outside the United States. The RBS Group continues to cooperate with these and other governmental and regulatory authorities in connection with ongoing investigations and the probable outcome is that it will incur additional financial penalties which may be material.

Legal, governmental and regulatory proceedings and investigations are subject to many uncertainties, and their outcomes, including the timing and amount of fines or settlements, which may be material, are often difficult to predict, particularly in the early stages of a case or investigation. Adverse regulatory proceedings or adverse judgments in litigation could result in restrictions or limitations on the RBS Group's operations or have a significant effect on the RBS Group's reputation, results of operations and capital position. It is expected that the RBS Group will continue to have a material exposure to legacy litigation and regulatory matter proceedings in the medium term. For more detail on certain of the RBS Group's ongoing legal, governmental and regulatory proceedings, see pages 307 to 315.

The RBS Group may be required to increase provisions in relation to ongoing legal proceedings, investigations and governmental and regulatory matters. In Q4 2013, the RBS Group booked a £1.9 billion provision to cover various claims and conduct related matters affecting Group companies, primarily those related to mortgage-backed securities and securities related litigation, following recent third party litigation settlements and regulatory decisions. It also increased its provision for Payment Protection Insurance redress and related costs by an additional £465 million for a cumulative provision of £3.1 billion. The provision for Interest Rate Hedging Products redress and administration costs was also increased to be a cumulative provision of £1.25 billion at 31 December 2013. Significant increases in provisions may harm the RBS Group's reputation and may have an adverse effect on the RBS Group's financial condition and results of operations.

The RBS Group, like many other financial institutions, has come under greater regulatory scrutiny in recent years and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with historical, new and existing corporate governance, employee compensation, conduct of business, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Past or current failure to comply with any one or more of these laws or regulations could have a significant adverse effect on the RBS Group's reputation, financial condition and results of operations.

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## Additional information

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

The RBS Group's ability to implement its strategy and its future success depends on its ability to attract, retain and remunerate highly skilled and qualified personnel, including its senior management, which include directors and other key employees, competitively with its peers. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and heightened scrutiny of, and (in some cases) restrictions placed upon, management and employee compensation arrangements, in particular those in receipt of Government support (such as the RBS Group).

In addition to the effects of such measures on the RBS Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of appropriately skilled personnel could place the RBS Group at a significant competitive disadvantage and prevent the RBS Group from successfully implementing its strategy, which could have a material adverse effect on the RBS Group's financial condition and results of operations.

During 2013 the RBS Group replaced its Group Chief Executive, Group Finance Director and Chief Risk Officer and its newly appointed Group Finance Director (October 2013) resigned and a search for a new Group Finance Director is continuing. The RBS Group's changing strategy, particularly with respect to its Markets business and recently announced disposition of RBS Citizens, has led to the exodus of talented staff. The lack of continuity of senior management and the loss of important personnel within the RBS Group could have an adverse impact on the implementation of the RBS Group's strategic objectives and regulatory commitments.

In addition, certain of the RBS Group's employees in the UK, continental Europe and other jurisdictions in which the RBS Group operates are represented by employee representative bodies, including trade unions. Engagement with its employees and such bodies is important to the RBS Group and a breakdown of these relationships could adversely affect the RBS Group's business, reputation and results.

**Operational risks are inherent in the RBS Group's businesses**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The RBS Group has complex and geographically diverse operations and operational risk and losses can result from internal and external fraud, errors by employees or third parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-bribery, anti-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, business continuity and data security system failures, natural disasters or the inadequacy or failure of systems and controls, including those of the RBS Group's suppliers or counterparties. Although the RBS Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures, to identify and rectify weaknesses in existing procedures and to train staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the RBS Group. Ineffective management of operational risks could have a material adverse effect on the RBS Group's business, financial condition and results of operations.

**The RBS Group operates in markets that are highly competitive and its business and results of operations may be adversely affected**

The competitive landscape for banks and other financial institutions in the UK, the US and throughout the rest of Europe is subject to rapid change and recent regulatory and legal changes are likely to result in new market participants and changed competitive dynamics in certain key areas, such as in retail banking in the UK. The competitive landscape in the UK will be particularly influenced by the UK government's implementation of the recommendations on competition included in the final report of the Independent Commission on Banking (ICB), including ring-fencing and other customer protection measures addressed in the Banking Reform Act 2013 which became law in the United Kingdom on 18 December 2013 and will be implemented through secondary legislation due to be completed by May 2015. In order to compete effectively, certain financial institutions may seek to consolidate their businesses or assets with other parties. This consolidation, in combination with the introduction of new entrants into the markets in which the RBS Group operates is likely to increase competitive pressures on the RBS Group.

In addition, certain competitors may have stronger and more efficient operations, including better IT systems allowing them to implement innovative technologies for delivering services to their customers, and may have access to lower cost funding and/or be able to attract deposits on more favourable terms than the RBS Group. Furthermore, the RBS Group's competitors may be better able to attract and retain clients and key employees, which may have a negative impact on the RBS Group's relative performance and future prospects. In addition, recent and future disposals and restructurings by the RBS Group and the compensation structure and restrictions imposed on the RBS Group may also have an impact on its ability to compete effectively.



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## Additional information

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### Risk factors continued

These and other changes to the competitive landscape could adversely affect the RBS Group's business, margins, profitability, financial condition and prospects.

#### The RBS Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions

The RBS Group's businesses and performance are affected by local and global economic conditions, perceptions of those conditions and future economic prospects. The outlook for the global economy over the near to medium-term is for steady growth. Prospects for the UK and the US in 2014 are the strongest among the G7. The outlook for Ireland is improving but remains challenging. Risks to growth and stability stem mainly from continued imbalances – among and within countries – and from uncertainty about how economies will respond as the extraordinary monetary policy measures implemented during the crisis are unwound. The RBS Group's businesses and performance are also affected by financial market conditions. Capital and credit markets around the world have been relatively stable since 2012. Although the risk of sovereign default relating to certain EU member states diminished during 2013, a number of EU countries including the UK had their credit ratings downgraded, and the lingering risk of a sovereign default continues to pose a threat to capital and credit markets. In addition, in response to actions of central banks, in particular the US Federal Reserve's actions with respect to tapering of its debt purchase program, there have been short periods of rapid movements in interest rates and significant sharp falls on equity markets and further market volatility is likely as tapering continues.

Challenging economic and market conditions create a difficult operating environment for the RBS Group's businesses, which is characterised by:

- reduced activity levels, additional write-downs and impairment charges and lower profitability, especially in combination with regulatory changes or action of market participants, which either alone or collectively may restrict the ability of the RBS Group to access funding and liquidity;
- central bank actions to engender economic growth which have resulted in a prolonged period of low interest rates constraining, through margin compression and low returns on assets, the interest income earned on the RBS Group's interest earning assets; and
- the risk of increased volatility in yields and asset valuations as central banks start/accelerate the process of tightening or unwinding historically unprecedented loose monetary policy or extraordinary measures. The resulting environment of uncertainty for the market and consumers will lead to challenging trading and market conditions.

In particular, should economic recovery stagnate, particularly in the RBS Group's key markets, or the scope and severity of the adverse economic conditions currently experienced by a number of EU member states and elsewhere worsen, the risks faced by the RBS Group would be exacerbated. Developments relating to the current economic conditions and the risk of a return to a volatile financial environment, including those discussed above, could have a material adverse effect on the RBS Group's business, financial condition, results of operations and prospects.

#### The RBS Group has significant exposure to a weakening of the nascent economic recovery in Europe

In Europe, countries such as Ireland, Italy, Greece, Portugal and Spain have been particularly affected by the recent macroeconomic and financial conditions. Although the risk of sovereign default continued to decline in 2013 due to the continuing actions of the European Central Bank (ECB) and the EU, the risk of default remains and yields on the sovereign debt of many EU member states have remained well above pre-crisis levels. This default risk raises concerns, and the possibility remains that the contagion effect spreads to other EU economies, including the UK economy, that the euro could be abandoned as a currency by one or more countries that have already adopted its use, or in an extreme scenario, that the abandonment of the euro could result in the dissolution of the European Monetary Union (EMU). This would lead to the re-introduction of individual currencies in one or more EMU member states.

The effects on the UK, European and global economies of any potential dissolution of the EMU, exit of one or more EU member states from the EMU and the redenomination of financial instruments from the euro to a different currency, are impossible to predict fully. However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk;
- result in downgrades of credit ratings for European borrowers, giving rise to increases in credit spreads and decreases in security values;
- disrupt and adversely affect the economic activity of the UK and other European markets; and
- adversely affect the management of market risk and in particular asset and liability management due, in part, to redenomination of financial assets and liabilities and the potential for mismatch.

The occurrence of any of these events would have a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

The RBS Group has significant exposure to private sector and public sector customers and counterparties in the eurozone (at 31 December 2013 principally Ireland (£39.8 billion), Germany (£31.1 billion), The Netherlands (£25.9 billion), France (£23.8 billion), Spain (£11.2 billion) and Italy (£7.1 billion)). The RBS Group's private and public sector exposures in the eurozone have been, and may in the future be, affected by credit losses and restructuring of their terms, principal, interest and maturity. In 2011, this included an impairment loss of £1.1 billion in respect of its holding of Greek government bonds. The public sector exposure comprises exposure to central and local governments and deposits with central banks. At 31 December 2013, the RBS Group's eurozone government debt exposure amounted to £15.9 billion (largely AFS and HFT debt securities exposure) including aggregate exposure of £2.8 billion to Ireland, Spain, Italy, Portugal Greece and Cyprus (largely net HFT debt securities exposure to Italy and Spain).

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## Additional information

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The RBS Group and its UK bank subsidiaries are subject to the provisions of the Banking Act 2009, as amended by the Banking Reform Act 2013, which includes special resolution powers including nationalisation and bail-in

Under the Banking Act 2009, substantial powers have been granted to HM Treasury, the Bank of England and the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) (together, the "Authorities") as part of a special resolution regime. These powers enable the Authorities to deal with and stabilise certain deposit-taking UK incorporated institutions that are failing, or are likely to fail, to satisfy the threshold conditions (within the meaning of section 41 of the Financial Services and Markets Act 2000 (FSMA), which are the conditions that a relevant entity must satisfy in order to obtain its authorisation to perform regulated activities). The special resolution regime consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity and/or the securities of the relevant entity to a private sector purchaser, (ii) transfer of all or part of the business of the relevant entity to a 'bridge bank' wholly owned by the Bank of England and (iii) temporary public ownership (nationalisation) of the relevant entity. If HM Treasury decides to take the RBS Group into temporary public ownership pursuant to the powers granted under the Banking Act 2009, it may take various actions in relation to any securities without the consent of holders of the securities.

Among the changes introduced by the Banking Reform Act 2013, the Banking Act 2009 is amended to insert a bail-in option as part of the powers of the UK resolution authority which option will come into force on such date as shall be stipulated by HM Treasury. The bail-in option will be introduced as an additional power available to the Bank of England to enable it to recapitalise a failed institution by allocating losses to its shareholders and unsecured creditors in a manner that seeks to respect the hierarchy of claims in liquidation. The bail-in option includes the power to cancel a liability, to modify the form of a liability (including the power to convert a liability from one form to another) or to provide that a contract under which the institution has a liability is to have effect as if a specified right had been exercised under it, each for the purposes of reducing, deferring or cancelling the liabilities of the bank under resolution, as well as to transfer a liability. The Banking Reform Act 2013 is consistent with the range of tools that Member States will be required to make available to their resolution authorities under the Recovery and Resolution Directive (RRD), although since the RRD remains in draft form, there can be no assurance that the bail-in option added under the Banking Reform Act will not need to change to comply with the RRD.

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan

The RBS Group was required to obtain State Aid approval for the aid given to the RBS Group by HM Treasury as part of the placing and open offer undertaken by the RBS Group in December 2008, the issuance to HM Treasury of £25.5 billion of B shares in the capital of the RBS Group which are, subject to certain terms and conditions, convertible into ordinary shares in the share capital of the RBS Group and a contingent commitment by HM Treasury (which has now been terminated) to subscribe for up to an additional £8 billion of B Shares if certain conditions are met in addition to the RBS Group's participation in the Asset Protection Scheme (APS) (which has now been terminated). In that context, as part of the terms of the State Aid approval, the RBS Group, together with HM Treasury, agreed the terms of a restructuring plan.

The RBS Group is subject to a variety of risks as a result of implementing the State Aid restructuring plan, including required asset disposals. In particular, the RBS Group agreed to undertake a series of measures including the disposal of a number of businesses now completed, the disposal of Direct Line Group (DLG) and the disposal of the Royal Bank branch-based business in England and Wales and the National Westminster Bank Plc (NatWest) branches in Scotland, along with the direct and other small and medium-size enterprise (SME) customers and certain mid-corporate customers across the UK. The initial sale of 34.7% of DLG through an IPO was completed in October 2012, with further sales in March and September 2013 reducing the RBS Group's stake to 28.5% at year-end, marking the continuation of the RBS Group's disposal strategy as part of its on-going delivery against EU-mandated commitments. In respect of the Royal Bank and NatWest branch-based business, the divestment process continues to progress following the withdrawal of its original buyer in October 2012 and a pre-IPO investment by a consortium of investors was announced in September 2013. The RBS Group is currently in discussions with HM Treasury and the EC in relation to certain matters, including the potential retirement of the Dividend Access Share.

There is no assurance that the price that the RBS Group receives or has received for any assets sold pursuant to the State Aid restructuring plan will be or has been at a level the RBS Group considers adequate or which it could obtain in circumstances in which the RBS Group was not required to sell such assets in order to implement the State Aid restructuring plan or if such sale were not subject to the restrictions contained in the terms thereof. Further, if the RBS Group fails to complete any of the required disposals within the agreed timeframes for such disposals, or fails to negotiate extensions in respect of such disposals, under the terms of the State Aid approval, a divestiture trustee may be empowered to conduct the disposals, with the mandate to complete the disposal at no minimum price.

Furthermore, if the RBS Group is unable to comply with the terms of the State Aid approval, it could constitute a misuse of aid. In circumstances where the EC doubts that the RBS Group is complying with the terms of the State Aid approval, it may open a formal investigation. At the conclusion of any such investigation, if the EC decided that there had been misuse of aid, it could issue a decision requiring HM Treasury to recover the misused aid, which could have a material adverse impact on the RBS Group.

In implementing the State Aid restructuring plan, the RBS Group has lost, and will continue to lose, existing customers, deposits and other assets (both directly through sale and potentially through the impact on the rest of the RBS Group's business arising from implementing the State Aid restructuring plan) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals.



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## Additional information

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### Risk factors continued

The disposal of Global Merchant Services and RBS Sempra Commodities reduced the RBS Group's assets by approximately £13.0 billion and £2.4 billion, respectively (based on total assets immediately prior to disposal). The quantum of assets and deposits that would be included in a divestment of the Royal Bank branch-based business in England and Wales and the NatWest branches in Scotland is not certain. However, at 31 December 2013, this business included approximately £19.4 billion of assets, £23.2 billion of deposits and two million customers.

The implementation of the State Aid restructuring plan may also result in disruption to the retained business and give rise to significant strain on management, employee, operational and financial resources, impacting customers and employees and giving rise to separation costs which could be substantial.

The implementation of the State Aid restructuring plan may result in the emergence of one or more new viable competitors or a material strengthening of one or more of the RBS Group's existing competitors in the RBS Group's markets. The effect of this on the RBS Group's future competitive position, revenues and margins is uncertain and there could be an adverse effect on the RBS Group's operations and financial condition and its business generally.

The occurrence of any of the risks described above could have a material adverse effect on the RBS Group's business, results of operations, financial condition, capital position and competitive position.

HM Treasury (or UK Financial Investments Limited (UKFI) on its behalf) may be able to exercise a significant degree of influence over the RBS Group and any proposed offer or sale of its interests may affect the price of securities issued by the RBS Group

The UK Government, through HM Treasury, currently holds 63.9% of the issued ordinary share capital of the RBS Group. On 22 December 2009, the RBS Group issued £25.5 billion of B Shares to the UK Government. The B Shares are convertible, at the option of the holder at any time, into ordinary shares. The UK Government has agreed that it shall not exercise the rights of conversion in respect of the B Shares if and to the extent that following any such conversion it would hold more than 75% of the total issued shares in the RBS Group. Any breach of this agreement could result in the delisting of the RBS Group from the Official List of the UK Listing Authority and potentially other exchanges where its securities are currently listed and traded. HM Treasury (or the UKFI on its behalf) may sell all or a part of the ordinary shares that it owns at any time. Any offers or sale of a substantial number of ordinary shares or securities convertible or exchangeable into ordinary shares by or on behalf of HM Treasury, or an expectation that it may undertake such an offer or sale, could negatively affect prevailing market prices for securities issued by the RBS Group.

In addition, UKFI manages HM Treasury's shareholder relationship with the RBS Group and, although HM Treasury has indicated that it intends to respect the commercial decisions of the RBS Group and that the RBS Group will continue to have its own independent board of directors and management team determining its own strategy, should its current intentions change, HM Treasury's position as a majority shareholder (and UKFI's position as manager of this shareholding) means that HM Treasury or UKFI may be able to exercise a significant degree of influence over, among other things, the election of directors and appointment of senior management, dividend policy, remuneration policy, or limiting the RBS Group's operations. The manner in which HM Treasury or UKFI exercises HM Treasury's rights as majority shareholder could give rise to conflict between the interests of HM Treasury and the interests of other shareholders. The Board has a duty to promote the success of the RBS Group for the benefit of its members as a whole.

### The RBS Group is subject to other global risks

By virtue of the RBS Group's global presence, the RBS Group is exposed to risks arising out of geopolitical events, such as the existence of trade barriers, the implementation of exchange controls and other measures taken by sovereign governments that can hinder economic or financial activity levels. Furthermore, unfavourable political, military or diplomatic events, armed conflict, pandemics and terrorist acts and threats, and the response to them by governments could also adversely affect levels of economic activity and have an adverse effect upon the RBS Group's business, financial condition and results of operations.

The RBS Group's business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements.

Effective management of the RBS Group's capital is critical to its ability to operate its businesses, and to pursue its strategy of returning to standalone strength. The RBS Group is required by regulators in the UK, the US and other jurisdictions in which it undertakes regulated activities to maintain adequate capital resources. The maintenance of adequate capital is also necessary for the RBS Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy and specifically in its core UK, US and European markets.

The Basel Committee on Banking Supervision's package of reforms to the regulatory capital framework raises the quantity and quality of capital required to be held by a financial institution with an emphasis on Common Equity Tier 1 (CET1) capital and introduces an additional requirement for both a capital conservation buffer and a countercyclical buffer to be met with CET1 capital. The Basel Committee also has proposed that global systemically important banks (GSIBs) be subject to an additional CET1 capital requirement, depending on a bank's systemic importance. The RBS Group has been identified by the Financial Stability Board (FSB) as a GSIB. The FSB list of GSIBs is updated annually, based on new data and changes to methodology. The November 2013 update placed the RBS Group in the second from bottom bucket of GSIBs, subjecting it to more intensive oversight and supervision and requiring to have additional loss absorption capacity of 1.5% in CET1 to be phased in from the beginning of 2016.

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## Additional information

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The Basel III rules are dependent on local implementation. The EU legislative package of proposals to implement the changes with a new Directive and Regulation (collectively known as “CRD IV”) was finalised in June 2013 paving the way for implementation of Basel III in the EU from 1 January 2014, subject to a number of transitional provisions and clarifications. A number of the requirements introduced under CRD IV will be further supplemented through the Regulatory and Implementing Technical Standards (RTSs/ITSs) produced by the European Banking Authority (EBA) which are not yet finalised. The EU rules deviate from the Basel III rules in certain aspects (e.g. in imposing an additional systemic risk buffer), and provide national flexibility to apply more stringent prudential requirements than set in the EU (or Basel) framework.

Since 1 January 2014, the RBS Group has been required to comply with the requirements of CRD IV, the EBA’s RTSs and ITSs and the PRA’s Policy Statement PS 7/13 (Strengthening capital standards: implementing CRD IV, feedback and final rules). The RBS Group must also operate by reference to the capital and leverage requirements set out by the PRA in its supervisory statement SS3/13 issued in November 2013 which is applicable to the eight major UK banks and building societies.

The provisions of PS7/13 embody PRA requirements to accelerate the introduction and phasing in of certain transitional provisions of CRD IV. The policy statement also sets out the intent of the PRA in respect of capital buffers as well as the approach to so-called Pillar 2 risks. By their nature, Pillar 2A risks, which contribute to the scaling of the RBS Group’s Individual Capital Guidance from the PRA, can include risks which the RBS Group considers would only materialise at the point of non-viability, an example being pension obligation risk. PS7/13 does not recognise this distinction and requires that Pillar 2A risks are met by at least 56% of CET1 by 1 January 2015.

The Banking Reform Act 2013, implementing the ICB recommendations, will introduce mechanisms requiring systemically important UK banks and building societies to hold loss-absorbing capacity, in addition to the capital held to satisfy their capital requirements under CRD IV as implemented by the PRA. These requirements, as well as other recommendations of the ICB, are to be established through secondary legislation and are expected to be phased in between 2015 and 2019. The US Federal Reserve has also recently adopted new rules relating to how it will regulate the US operations of foreign banking operations such as the RBS Group that may affect the capital requirements of the RBS Group’s operations in the US. As the implementation of the ICB recommendations is the subject of secondary legislation not yet adopted and the Federal Reserve has only recently adopted its final rules, the RBS Group cannot predict the impact such rules will have on the RBS Group’s overall capital requirements or how they will affect the RBS Group’s compliance with applicable capital and loss absorbency requirements.

To the extent the RBS Group has estimated the indicative impact that CRD IV rules may have on its risk-weighted assets and capital ratios, such estimates are preliminary and subject to uncertainties and may change. In particular, the estimates assume mitigating actions will be taken by the RBS Group (such as deleveraging of legacy positions and securitisations, including RCR as well as other actions being taken to de-risk market and counterparty exposures), which may not occur as anticipated, in a timely manner, or at all.

The Basel Committee changes and other future changes to capital adequacy and liquidity requirements in the European Union, the UK, the US and in other jurisdictions in which the RBS Group operates, including any application of increasingly stringent stress case scenarios by the regulators in the UK, the US and other jurisdictions in which the RBS Group undertakes regulated activities, may require the RBS Group to raise additional Tier 1 (including CET1) and Tier 2 capital by way of further issuances of securities, and may result in existing Tier 1 and Tier 2 securities issued by the RBS Group ceasing to count towards the RBS Group’s regulatory capital, either at the same level as at present or at all.

The requirement to raise additional CET1 capital, which could be mandated by the RBS Group’s regulators, could have a number of negative consequences for the RBS Group and its shareholders, including impairing the RBS Group’s ability to pay dividends on, or make other distributions in respect of, ordinary shares and diluting the ownership of existing shareholders of the RBS Group. If the RBS Group is unable to raise the requisite Tier 1 and Tier 2 capital, it may be required to reduce further the amount of its risk-weighted assets or total assets and engage in the disposal of core and other non-core businesses, which may not occur on a timely basis or achieve prices which would otherwise be attractive to the RBS Group.

At 31 December 2013, the RBS Group’s Tier 1 and Core Tier 1 capital ratios were 13.1% and 10.9%, respectively, calculated in accordance with PRA requirements. On a fully loaded Basel III basis, the RBS Group’s equivalent CET1 ratio was 8.6%. The RBS Group continues to target a fully loaded Basel III CET1 ratio of approximately 11% by the end of 2015 and to be at 12% or above by the end of 2016. The RBS Group’s ability to achieve such targets will turn on a number of factors, including the implementation of the RBS Group’s strategy which calls for a significant downsizing of the RBS Group in part through the sale of RBS Citizens in the U.S. See “Forward looking Statements” and “The RBS Group’s ability to implement its new strategic plan and achieve its capital goals depends on the success of the RBS Group’s plans to refocus on its core strengths and the timely divestment of RBS Citizens”.

Any change that limits the RBS Group’s ability to manage effectively its balance sheet and capital resources going forward (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, regulatory changes, actions by regulators, delays in the disposal of certain key assets or the inability to syndicate loans as a result of market conditions, a growth in unfunded pension exposures or otherwise), to implement its capital plan or to access funding sources, could have a material adverse effect on its financial condition and regulatory capital position.

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## Additional information

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### Risk factors continued

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

The credit ratings of RBSG, RBS other Group members have been subject to change and may change in the future, which could impact their cost of, access to and sources of financing and liquidity. A number of UK and other European financial institutions, including RBSG, the Royal Bank and other Group members, have been downgraded multiple times during the last three years in connection with rating methodology changes, a review of systemic support assumptions incorporated into bank ratings and the likelihood, in the case of UK banks, that the UK Government is more likely in the future to make greater use of its resolution tools to allow burden sharing with debt holders. Most recently credit ratings of RBSG, the Royal Bank and other Group members were downgraded in connection with the RBS Group's creation of RCR coupled with concerns about execution risk, litigation risk and the potential for conduct related fines. Furthermore, subject to any mitigating factors, uncertainties resulting from an affirmative vote in favour of Scottish independence would be likely to have a negative impact on the credit ratings of RBSG and the Royal Bank.

Rating agencies continue to evaluate the rating methodologies applicable to UK and European financial institutions and any change in such rating agencies' methodologies could materially adversely affect the credit ratings of Group companies. Any further reductions in the long-term or short-term credit ratings of RBSG or one of its principal subsidiaries (particularly the Royal Bank) would increase its borrowing costs, require the RBS Group to replace funding lost due to the downgrade, which may include the loss of customer deposits, and may also limit the RBS Group's access to capital and money markets and trigger additional collateral requirements in derivatives contracts and other secured funding arrangements. At 31 December 2013, a simultaneous one notch long-term and associated short-term downgrade in the credit ratings of RBSG and the Royal Bank by the three main ratings agencies would have required the RBS Group to post estimated additional collateral of £10 billion, without taking account of mitigating action by management.

Any downgrade in the UK Government's credit ratings could adversely affect the credit ratings of Group companies and may have the effects noted above. In December 2012, Standard & Poor's placed the UK's AAA credit rating on credit watch, with negative outlook and, in February 2013, Moody's downgraded the UK's credit rating one notch to Aa1. Credit ratings of RBSG, the Royal Bank, The Royal Bank of Scotland N.V. (RBS N.V.), Ulster Bank Limited and RBS Citizens are also important to the RBS Group when competing in certain markets, such as over-the-counter derivatives. As a result, any further reductions in the RBS Group's long-term or short-term credit ratings or those of its principal subsidiaries could adversely affect the RBS Group's access to liquidity and its competitive position, increase its funding costs and have a material adverse impact on the RBS Group's earnings, cash flow and financial condition.

The RBS Group's ability to meet its obligations including its funding commitments depends on the RBS Group's ability to access sources of liquidity and funding

Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of factors, including an over reliance on a particular source of wholesale funding (including, for example, short-term and overnight funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide, including interbank markets, have experienced severe reductions in liquidity and term-funding during prolonged periods in recent years. Although credit markets continued to improve during 2013 (in part as a result of measures taken by central banks around the world, including the ECB), and the RBS Group's overall liquidity position remained strong, certain European banks, in particular from the peripheral countries of Spain, Portugal, Greece, Italy and Ireland, remained reliant on central banks as one of their principal sources of liquidity. Although the measures taken by Central Banks have had a positive impact, the risk of volatility returning to the global credit markets remains.

The market perception of bank credit risk has changed significantly as a result of the financial crisis and banks that are deemed by the market to be riskier have had to issue debt at a premium. Any uncertainty regarding the perception of credit risk across financial institutions may lead to reductions in levels of interbank lending and associated term maturities and may restrict the RBS Group's access to traditional sources of funding or increase the costs of accessing such funding. The ability of the RBS Group's regulator to bail-in senior debt which may be exercised as soon as either the provisions of the Banking Reform Act 2013 are implemented through secondary legislation or the RRD comes into effect, may also increase investors' perception of risk and hence affect the availability and cost of funding for the RBS Group.

The RBS Group's liquidity and funding management focuses, among other things, on maintaining a diverse and appropriate funding strategy for its assets in line with the RBS Group's wider strategic plan. The RBS Group has, at times, been required to rely on shorter-term and overnight funding with a consequent reduction in overall liquidity, and to increase its recourse to liquidity schemes provided by central banks. Such schemes require the pledging of assets as collateral and changes to asset valuations or eligibility criteria can negatively impact the available assets and reduce available liquidity access particularly during periods of stress when such lines may be needed most. Although conditions have improved, there have been recent periods where corporate and financial institution counterparties have reduced their credit exposures to banks and other financial institutions, limiting the availability of these sources of funding. Under certain circumstances, the RBS Group may need to seek funds from alternative sources potentially at higher costs than has previously been the case, and/or with higher collateral or may be required to consider disposals of other assets not previously identified for disposal to reduce its funding commitments.

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## Additional information

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The RBS Group relies on customer deposits to meet a considerable portion of its funding and it has targeted maintaining a loan to deposit ratio of around 100%. The level of deposits may fluctuate due to certain factors outside the RBS Group's control, such as a loss of confidence, increasing competitive pressures for retail customer deposits or the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors, which could result in a significant outflow of deposits within a short period of time. An inability to grow, or any material decrease in, the RBS Group's deposits could, particularly if accompanied by one of the other factors described above, have a material adverse impact on the RBS Group's ability to satisfy its liquidity needs.

The occurrence of any of the risks described above could have a material adverse impact on the RBS Group's financial condition and results of operations.

*The regulatory capital treatment of certain deferred tax assets recognised by the RBS Group depends on there being no adverse changes to regulatory requirements*

While there was no restriction on the recognition of deferred tax assets at 31 December 2013, the Capital Requirements Regulation, which took effect from 1 January 2014, requires the deduction in full from CET1 capital of deferred tax assets that rely on future profitability and do not arise from temporary differences (for example, deferred tax assets related to trading losses). Other deferred tax assets which rely on future profitability and arise from temporary differences are subject to a threshold test and only the amount in excess of the threshold is deducted from CET1 capital. The PRA has not adopted the transitional provisions in relation to the change in the treatment of deferred tax assets and therefore the threshold deduction has the potential to impact CET1 capital from 1 January 2014.

*Each of the RBS Group's businesses is subject to substantial regulation and oversight. Significant regulatory developments and changes in the approach of the RBS Group's key regulators has had and is likely to continue to have a material adverse effect on how the RBS Group conducts its business and on its results of operations and financial condition*

The RBS Group is subject to extensive financial services laws, regulations, corporate governance requirements, administrative actions and policies in each jurisdiction in which it operates. Many of these have been changing and are subject to further change, particularly in the current regulatory and market environment, where there have been unprecedented levels of government intervention (including nationalisations and injections of government capital), changes to the regulations governing financial institutions and reviews of the industry, in the UK, in many other European countries, the US and at the EU level.

As a result of the environment in which the RBS Group operates, increasing regulatory focus in certain areas and ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the RBS Group's participation in government or regulator-led initiatives), the RBS Group is facing greater regulation and scrutiny in the UK, the US and other countries in which it operates (including in relation to compliance with anti-bribery, anti-money laundering, anti-terrorism and other similar sanctions regimes).

Although it is difficult to predict with certainty the effect that all of the recent regulatory changes, developments and heightened levels of public and regulatory scrutiny will have on the RBS Group, the enactment of legislation and regulations in the UK and the EU, the other parts of Europe in which the RBS Group operates and the US (such as the bank levy and Banking Reform Act 2013 in the UK, the RRD and CRD IV or the Dodd-Frank Wall Street Reform and Consumer Protection Act in the US) has resulted in increased capital and liquidity requirements, changes in other regulatory requirements and increased operating costs and has impacted, and will continue to impact, products offerings and business models. The RBS Group may not be able to meet increased capital requirements by reducing lending which could result in the RBS Group being obliged to continue to deploy capital in less profitable areas than it might otherwise have chosen. Such changes may also result in an increased number of regulatory investigations and proceedings. Any of these developments could have an impact on how the RBS Group conducts its business, applicable authorisations and licences, the products and services it offers, its reputation, the value of its assets, and a material adverse effect on its funding costs and its results of operations and financial condition.

Areas in which, and examples of where, governmental policies, regulatory and accounting changes and increased public and regulatory scrutiny could have an adverse impact (some of which could be material) on the RBS Group include those set out above as well as the following:

- the monetary, fiscal, interest rate and other policies of central banks and other governmental or regulatory bodies;
- requirements to separate retail banking from investment banking;
- restrictions on proprietary trading and similar activities within a commercial bank and/or a group which contains a commercial bank;
- restructuring certain of the RBS Group's non-retail banking activities in jurisdictions outside the UK in order to satisfy local capital, liquidity and other prudential requirements;
- the design and potential implementation of government mandated recovery, resolution or insolvency regimes;
- the imposition of government imposed requirements and/or related fines and sanctions with respect to lending to the UK SME market and larger commercial and corporate entities and residential mortgage lending;
- requirements to operate in a way that prioritises objectives other than shareholder value creation;
- changes to financial reporting standards (including accounting standards), corporate governance requirements, corporate structures and conduct of business rules;
- the imposition of restrictions on the RBS Group's ability to compensate its senior management and other employees;



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## Additional information

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### Risk factors continued

- regulations relating to, and enforcement of, anti-bribery, anti-money laundering, anti-terrorism or other similar sanctions regimes;
- rules relating to foreign ownership, expropriation, nationalisation and confiscation of assets;
- other requirements or policies affecting the RBS Group's profitability, such as the imposition of onerous compliance obligations, further restrictions on business growth, product offering, capital, liquidity or pricing;
- the introduction of, and changes to, taxes, levies or fees applicable to the RBS Group's operations (such as the imposition of a financial transaction tax and changes in tax rates that reduce the value of deferred tax assets); and
- the regulation or endorsement of credit ratings used in the EU (whether issued by agencies in EU member states or in other countries, such as the US).

Changes in laws, rules or regulations, or in their interpretation or enforcement, or the implementation of new laws, rules or regulations, including contradictory laws, rules or regulations by key regulators in different jurisdictions, may have a material adverse effect on the RBS Group's business, financial condition and results of operations. In addition, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect the RBS Group's ability to engage in effective business, capital and risk management planning.

The RBS Group is subject to a number of regulatory initiatives which may adversely affect its business. The Independent Commission on Banking's final report on competition and structural reforms in the UK banking industry has been substantially adopted by the UK Government through the passage of the Banking Reform Act 2013. In addition other proposals to ring fence certain business activities and the US Federal Reserve's proposal for applying US capital, liquidity and enhanced prudential standards to certain of the RBS Group's US operations together with the UK reforms could require structural changes to the RBS Group's business. Any of these changes could have a material adverse effect on the RBS Group.

The UK Government published a White Paper on Banking Reform in September 2012, outlining proposed structural reforms in the UK banking industry. The measures proposed were drawn in large part from the recommendations of the ICB, which was appointed by the UK Government in June 2010. The ICB published its final report to the Cabinet Committee on Banking Reform on 12 September 2011, which set out the ICB's views on possible reforms to improve stability and competition in UK banking. The final report made a number of recommendations, including in relation to (i) promotion of competition, (ii) increased loss absorbency (including bail-in) and (iii) the implementation of a ring-fence of retail banking operations.

The measures in relation to the promotion of competition are already largely in process, including the development of an industry mechanism to make it easier for customers to switch their personal current accounts to a different provider, which was introduced in September 2013.

Bail-in mechanisms, will, if used, affect the rights of creditors, including holders of senior and subordinated bonds, and shareholders in the event of the implementation of a resolution scheme or an insolvency and could thereby materially affect the price of such securities. Such mechanics are being implemented through the Banking Reform Act 2013 and will also be part of the RRD. The implementation of a ring-fence of retail banking operations is also included in the Banking Reform Act 2013. The Banking Reform Act 2013 provides primary enabling legislation in the short term with a view to completing the legislative framework for the ring-fence of retail banking operations by May 2015, requiring compliance as soon as practicable thereafter and setting a final deadline for full implementation by 2019.

The impact of any final legislation on the RBS Group is difficult to estimate with any precision at this stage. The Statutory Instruments setting out the scope of the ring-fence required by the Banking Reform Act 2013 are currently under discussion and final versions are expected to be published at some point in the summer of 2014. The PRA will have responsibility for drawing up the ring-fencing rules which will impact on the governance and operation of the ring-fenced bank. It is understood that the first consultation on the PRA rules will commence around the summer of 2014. It is also likely that ring-fencing certain of the RBS Group's operations would require significant restructuring with the possible transfer of large numbers of customers between legal entities. Ring-fencing is also likely to entail changes to the structure of the RBS Group's existing pension arrangements, so as to ensure that any ring-fenced and non-ring-fenced banks that may eventually be established should not be liable for each other's pension liabilities. Any such changes could result in additional costs and increased operational risks. It is possible that such ring-fencing, by itself, or taken together with the impact of other proposals contained in this legislation and other EU legislation that will apply to the RBS Group could have a material adverse effect on the RBS Group's structure and on the viability of certain businesses, in addition to the RBS Group's results of operations, financial conditions and prospects.

On 29 January 2014, the EC published proposals on structural measures to improve the resilience of EU credit institutions which included potential separation of certain trading activities from retail banking operations. The proposal currently contemplates that member states having already implemented ring-fencing legislation, such as the UK, may apply for a derogation from the separation of trading activities provisions included in the proposals if they can satisfy the EC that such local legislation meets the objectives and requirements set out in the EU proposal. The timeline envisaged under the proposals would be the effective separation of other trading activities to apply as of 1 July 2018.

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## Additional information

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Under the US Federal Reserve's new rules which change how it regulates the US operations of large foreign banking groups (the "FBO Rules"), foreign banking organisations with total global consolidated assets of \$50 billion or more ("Large FBOs") and Large FBOs with total US assets of \$50 billion or more (excluding assets of US branches and agencies of a Large FBO's foreign banks and certain other US subsidiaries) will have to create a separately capitalised top-tier US intermediate holding company (IHC) that would hold all US bank and non-bank subsidiaries. The IHC would be subject to US capital, liquidity and other enhanced prudential standards on a consolidated basis. Among other things, an IHC will be subject to the same US risk based and leverage capital standards that apply to a US bank holding company.

The imposition of US capital, liquidity and other enhanced prudential standards, including capital planning and stress testing requirements, on an IHC of a Large FBO such as the RBS Group that is subject to home country capital standards on a group-wide consolidated basis would likely give rise to challenging organisational and compliance issues and could make it more difficult to manage capital and liquidity efficiently on a global, consolidated basis. The foregoing is only one example of issues that the RBS Group may confront as a result of the application of the FBO Rules to its US operations.

As a result of the adoption of the ring-fence proposals in the UK and the potential adoption of the other proposals described above, major changes to the RBS Group's corporate structure, its business activities conducted in the UK and the US and potentially other jurisdictions where the RBS Group operates, as well as changes to the RBS Group's business model, are likely to be required. The changes include ring-fencing certain core banking activities in the UK from other activities of the RBS Group as well as restructuring other operations within the RBS Group in order to comply with these proposed new rules and regulations. The proposals, when adopted, are expected to take an extended period of time to put into place, to be costly to implement and may lack harmonisation, all of which could have a material adverse effect on the RBS Group's structure, reputation, results of operations, financial condition and prospects.

The RBS Group is subject to resolution procedures under current and proposed resolution and recovery schemes which may result in various actions being taken in relation to any securities of the RBS Group, including the write off, write-down or conversion of the RBS Group's securities

As a result of its status as a GSIFI and in accordance with current and proposed resolution and recovery schemes and the Prudential Standards issued by the PRA on 19 December 2013 on recovery and resolution planning, the RBS Group was required to meet certain resolution planning requirements contemplating its possible failure by the end of 2012 and 2013 and will be required to meet others in 2014. The RBS Group made the required submissions in 2012 to the Financial Services Authority (FSA) (now the PRA) and its US business made their required submissions to the Federal Reserve and the FDIC in H1 2013 and further submissions will be required to be made in 2014. Similar to other major financial institutions, both the RBS Group and its key subsidiaries remain engaged in a constructive dialogue on resolution and recovery planning with key national regulators and other authorities. The Prudential Standards issued by the PRA may evolve over time to ensure continued consistency with the Financial Stability Board's (FSB) recommendations and the technical standards and guidelines produced by the European Banking Authority to implement the RRD.

In addition to the powers provided by the Banking Act 2009, as amended by the Banking Reform Act 2013, that include a bail-in power which could be implemented prior to January 2015, resolution powers will also be included in the RRD. The EU Member States, the European Parliament and the EC reached a political agreement as announced on 12 December 2013 on the RRD (which remains subject to technical finalisation and formal approval by the co-legislators) and current expectations are that the RRD will be finalised during the second quarter of 2014. The draft RRD includes a "bail-in" tool, which would give the relevant supervisory authorities the power to write down or write off claims (including debt securities issued by the RBS Group and its subsidiaries) of certain unsecured creditors of a failing institution and/or to convert certain debt claims to equity. Except for the general bail-in tool, which is now expected to be implemented by 1 January 2016, it is currently contemplated that the measures set out in the draft RRD (including the power of authorities to write off or convert Additional Tier 1 and Tier 2 instruments) will be implemented with effect from 1 January 2015.

Such bail-in mechanism, which is anticipated to be consistent with the powers granted under the Banking Reform Act 2013, pursuant to which losses would be imposed on shareholders and, as appropriate, creditors (including senior creditors) of the RBS Group (through write-down or conversion into equity of liabilities including debt securities) would be used to recapitalise and restore the RBS Group to solvency as well as other options, including those as set forth in the Banking Act 2009, as amended by the Banking Reform Act 2013, following the recommendations of the ICB. The methods for implementation of any resolution and recovery scheme remain the subject of significant debate, particularly for GSIFIs with complex cross border activities. Such debate includes whether the bail-in tool may be exercised through a single point of entry at the holding company or at various levels of the corporate structure of a GSIFI.

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## Additional information

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### Risk factors continued

The potential impacts of these resolution and recovery powers may include the total loss of value of securities issued by the RBS Group and, in addition for debt holders, the possible conversion into equity securities, and under certain circumstances the inability of the RBS Group to perform its obligations under its securities. As these resolution and recovery measures remain subject to further implementation both at the European and UK level, changes may be made in the course of the legislative process, which may affect their impact on the RBS Group and securities issued by the RBS Group.

### The RBS Group's operations are highly dependent on its information technology systems

The RBS Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The proper functioning of the RBS Group's payment systems, financial and sanctions controls, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between its branches and main data processing centres, are critical to the RBS Group's operations. Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the RBS Group's ability to service its clients, could result in significant compensation costs, could breach regulations under which the RBS Group operates and could cause long-term damage to the RBS Group's business and brand.

For example, failure to protect the RBS Group's operations from cyber-attacks could result in the loss of customer data or other sensitive information. During 2013, the RBS Group experienced a number of IT failures following a series of deliberate attacks which temporarily prevented RBS, RBS Citizens and NatWest customers from accessing their accounts or making payments. The Bank of England, the FCA and HM Treasury have identified cyber security as a systemic risk to the UK financial sector and highlighted the need for financial institutions to improve resilience to cyber-attacks.

In addition to meeting the requirements of the Bank of England's programme of work to improve and test financial institutions' resilience to cyber-attacks due to be completed during the first quarter of 2014, the RBS Group expects greater regulatory engagement on cyber security in the future. Although the RBS Group has been implementing remedial actions to improve its resilience to the increasing intensity and sophistication of cyber-attacks, the RBS Group expects to be the target of continued attacks in the future and there can be no assurance that the RBS Group will be able to prevent all threats.

In addition, in June 2012 and more recently in November 2013, computer system failures prevented NatWest, RBS and Ulster Bank customers from accessing accounts in both the UK and Ireland. Ongoing issues relating to the failure continued for several months, requiring the RBS Group to set aside a provision for compensation to customers who suffered losses as a result of the system failure, in addition to other related costs. See page 285. The vulnerabilities of the RBS Group's IT systems are due to the complexity of the RBS Group's IT infrastructure attributable in part to overlapping multiple legacy systems acquired through the RBS Group's acquisitions and resulting gaps in how the IT systems operate, and insufficient investments in IT infrastructure in the past, creating challenges in recovering from system breakdowns.

### The RBS Group's operations have inherent reputational risk

Reputational risk, meaning the risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the RBS Group's conduct and performance, is inherent in the RBS Group's business. Stakeholders include customers, investors, rating agencies, employees, suppliers, government, politicians, regulators, special interest groups, consumer groups, media and the general public. Brand damage can be detrimental to the business of the RBS Group in a number of ways, including its ability to build or sustain business relationships with customers, low staff morale, regulatory censure or reduced access to, or an increase in the cost of, funding. In particular, negative public opinion resulting from the actual or perceived manner in which the RBS Group conducts its business activities, the RBS Group's financial performance, the level of direct and indirect government support or actual or perceived practices in the banking and financial industry may adversely affect the RBS Group's ability to keep and attract customers and, in particular, corporate and retail depositors. Modern technologies, in particular online social networks and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the impact of damaging information and allegations. The RBS Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk, which may result in a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

### The RBS Group may suffer losses due to employee misconduct

The RBS Group's businesses are exposed to risk from potential non-compliance with policies, employee misconduct or negligence and fraud, which could result in regulatory sanctions and serious reputational or financial harm to the RBS Group. In recent years, a number of multinational financial institutions, including the RBS Group, have suffered material losses due to the actions of employees. It is not always possible to deter employee misconduct and the precautions the RBS Group takes to prevent and detect this activity may not always be effective.

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## Additional information

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

Severe market events have resulted in the RBS Group recording large write-downs on its credit market exposures in recent years. Any deterioration in economic and financial market conditions or continuing weak economic growth could lead to further impairment charges and write-downs. Moreover, market volatility and illiquidity (and the assumptions, judgements and estimates in relation to such matters that may change over time and may ultimately not turn out to be accurate) make it difficult to value certain of the RBS Group's exposures, for example, the assets included in the CRG. Valuations in future periods, reflecting, among other things, the then prevailing market conditions and changes in the credit ratings of certain of the RBS Group's assets, may result in significant changes in the fair values of the RBS Group's exposures, including in respect of exposures, such as credit market exposures, for which the RBS Group has previously recorded write-downs. In addition, the value ultimately realised by the RBS Group may be materially different from the current or estimated fair value. As part of the RBS Group's strategy it has materially reduced the size of its balance sheet mainly through the sale and run-off of non-core assets. Certain of the RBS Group's assets that were part of its Non-Core division together with additional assets identified as part of a HM Treasury review, form part of CRG as of 1 January 2014.

In connection with the establishment of CRG, the RBS Group has indicated its clear aspiration to remove the vast majority, if not all of these assets within three years which has led to increased impairments of £4.5 billion which were recognised in Q4 2013. Despite these impairments, these assets may be difficult to sell and could be subject to further write-downs or, when sold, realised losses. Any of these factors could require the RBS Group to recognise further significant write-downs or realise increased impairment charges, which may have a material adverse effect on its financial condition, results of operations and capital ratios. In addition, steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by losses in recent years arising out of asset-backed collateralised debt obligations, residential mortgage-backed securities and the leveraged loan market. In dislocated markets, hedging and other risk management strategies may not be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties.

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

The RBS Group maintains a number of defined benefit pension schemes for past and a number of current employees. Pension risk is the risk that the assets of the RBS Group's various defined benefit pension schemes which are long-term in nature do not fully match the timing and amount of the schemes' liabilities, as a result of which the RBS Group is required or chooses to make additional contributions to the schemes. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in applicable legislation. The schemes' assets comprise investment portfolios that are held to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of these asset portfolios, returns from them and any additional future contributions to the schemes, may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities.

In these circumstances, the RBS Group could be obliged, or may choose, to make additional contributions to the schemes. Given the recent economic and financial market difficulties and the risk that such conditions may occur again over the near and medium term, the RBS Group could experience increasing pension deficits or be required or elect to make further contributions to its pension schemes and such deficits and contributions could be significant and have an adverse impact on the RBS Group's results of operations or financial condition. The most recent tri-annual funding valuation, at 31 March 2010 was agreed during 2011. It showed the value of liabilities exceeded the value of assets by £3.5 billion at 31 March 2010, a ratio of assets to liabilities of 84%.

In order to eliminate this deficit, the RBS Group has been and will continue to pay additional contributions each year over the period 2011 until 2018. Contributions started at £375 million per annum in 2011, increased to £400 million per annum in 2013 and will further increase from 2016 onwards in line with price inflation. These contributions are in addition to the regular annual contributions of around £200 million for on-going accrual of benefits as well as contributions to meet the expenses of running the schemes.



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## Additional information

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### Risk factors continued

The Banking Reform Act 2013 will require banks to ring-fence specific activities (principally retail and small business deposits) from certain other activities. Ring-fencing is likely to entail changes to the structure of the RBS Group's existing defined benefit pension schemes, which could affect assessments of the schemes' deficits. Such assessments may also be affected by other measures introduced in the Banking Reform Act 2013, including the categorisation of deposits eligible for compensation under the Financial Services Compensation Scheme as preferential debts.

The financial performance of the RBS Group has been, and continues to be, materially affected by counterparty credit quality and deteriorations could arise due to prevailing economic and market conditions and legal and regulatory developments.

The RBS Group has exposure to many different industries and counterparties, and risks arising from actual or perceived changes in credit quality and the recoverability of monies due from borrowers and counterparties are inherent in a wide range of the RBS Group's businesses. In particular, the RBS Group has significant exposure to certain individual counterparties in weakened business sectors and geographic markets and also has concentrated country exposure in the UK, the US and across the rest of Europe (principally Germany, The Netherlands, Ireland and France) (at 31 December 2013 credit risk assets in the UK were £320.0 billion, in North America £96.1 billion and in Western Europe (excluding the UK) £104.3 billion); and within certain business sectors, namely personal finance, financial institutions, shipping and commercial real estate (at 31 December 2013 personal finance lending amounted to £177.1 billion, lending to financial institutions was £91.0 billion, lending against ocean going vessels was £8.6 billion and commercial real estate lending was £52.6 billion). The RBS Group expects its exposure to the UK to increase proportionately as its business becomes more concentrated in the UK, with exposures generally being reduced in other parts of its business as it continues to implement its strategy.

The credit quality of the RBS Group's borrowers and counterparties is impacted by prevailing economic and market conditions and by the legal and regulatory landscape in their respective markets.

A further deterioration in economic and market conditions or changes to legal or regulatory landscapes could worsen borrower and counterparty credit quality and also impact the RBS Group's ability to enforce contractual security rights. In addition, the RBS Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the RBS Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those experienced in recent years. This has been particularly the case with respect to large parts of the RBS Group's commercial real estate portfolio. Any such losses could have an adverse effect on the RBS Group's results of operations and financial condition.

Concerns about, or a default by, one financial institution could lead to significant liquidity problems and losses or defaults by other financial institutions, as the commercial and financial soundness of many financial institutions may be closely related as a result of credit, trading, clearing and other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses for, or defaults by, the RBS Group. This systemic risk may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with which the RBS Group interacts on a daily basis, all of which could have a material adverse effect on the RBS Group's access to liquidity or could result in losses which could have a material adverse effect on the RBS Group's financial condition, results of operations and prospects.

In certain jurisdictions in which the RBS Group does business, particularly Ireland, additional constraints have been imposed in recent years on the ability of certain financial institutions to complete foreclosure proceedings in a timely manner (or at all), including as a result of interventions by certain states and local and national governments.

These constraints have lengthened the time to complete foreclosures, increased the backlog of repossessed properties and, in certain cases, have resulted in the invalidation of purported foreclosures.

The EU, the ECB, the International Monetary Fund and various national authorities have proposed and implemented certain measures intended to address systemic financial stresses in the Eurozone, including the creation of a European Banking Union which, through a Single Resolution Mechanism (SRM) will apply the substantive rules of bank recovery and resolution set out in the RRD. Current expectations are that the RRD, which is intended to provide supervisory authorities with common tools and powers to address banking crises pre-emptively in order to safeguard financial stability and minimise taxpayers' exposure to losses, will be finalised early in 2014. The effectiveness of these and other actions proposed and implemented at both the EU and national level to address systemic stresses in the Eurozone is not assured.

The trends and risks affecting borrower and counterparty credit quality have caused, and in the future may cause, the RBS Group to experience further and accelerated impairment charges, increased repurchase demands, higher costs, additional write-downs and losses for the RBS Group and an inability to engage in routine funding transactions.

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## Additional information

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Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect the RBS Group's business and results of operations

Some of the most significant market risks the RBS Group faces are interest rate, foreign exchange, credit spread, bond, equity and commodity prices and basis, volatility and correlation risks. Changes in interest rate levels (or extended periods of low interest rates such as experienced over the past several years), yield curves (which remain depressed) and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the RBS Group's non-UK subsidiaries and may affect the RBS Group's reported consolidated financial condition or its income from foreign exchange dealing. For accounting purposes, the RBS Group values some of its issued debt, such as debt securities, at the current market price. Factors affecting the current market price for such debt, such as the credit spreads of the RBS Group, may result in a change to the fair value of such debt, which is recognised in the income statement as a profit or loss.

The performance of financial markets affects bond, equity and commodity prices, which has caused, and may in the future cause, changes in the value of the RBS Group's investment and trading portfolios. As part of its on-going derivatives operations, the RBS Group also faces significant basis, volatility and correlation risks, the occurrence of which are also impacted by the factors noted above.

While the RBS Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the RBS Group's financial performance and business operations.

*The value or effectiveness of any credit protection that the RBS Group has purchased depends on the value of the underlying assets and the financial condition of the insurers and counterparties*

The RBS Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), and other credit derivatives, each of which are carried at fair value. The fair value of these CDSs, as well as the RBS Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which protection has been bought. Many market counterparties have been adversely affected by their exposure to residential mortgage linked and corporate credit products, whether synthetic or otherwise, and their actual and perceived creditworthiness may deteriorate rapidly. If the financial condition of these counterparties or their actual or perceived creditworthiness deteriorates, the RBS Group may record further credit valuation adjustments on the credit protection bought from these counterparties under the CDSs. The RBS Group also recognises any fluctuations in the fair value of other credit derivatives. Any such adjustments or fair value changes may have a material adverse impact on the RBS Group's financial condition and results of operations.

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

In the UK, the Financial Services Compensation Scheme (FSCS) was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable or likely to be unable, to pay claims against it and may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under the Banking Act 2009. The FSCS is funded by levies on firms authorised by the FCA, including the RBS Group. In the event that the FSCS raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the RBS Group may have an adverse impact on its results of operations and financial condition. In addition, the RRD will require the establishment of national resolution funds, which will require ex ante levies on banks and investment firms to ensure that the resolution tools contemplated by the RRD can be applied effectively.

To the extent that other jurisdictions where the RBS Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the US with the Federal Deposit Insurance Corporation), the RBS Group may make further provisions and may incur additional costs and liabilities, which may have an adverse impact on its financial condition and results of operations.

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

Under International Financial Reporting Standards (IFRS), the RBS Group recognises at fair value: (i) financial instruments classified as held-for-trading or designated as at fair value through profit or loss; (ii) financial assets classified as available-for-sale; and (iii) derivatives.

Generally, to establish the fair value of these instruments, the RBS Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data.

In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to prevailing market conditions. In such circumstances, the RBS Group's internal valuation models require the RBS Group to make assumptions, judgements and estimates to establish fair value, which are complex and often relate to matters that are inherently uncertain. These assumptions, judgements and estimates will need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the RBS Group's earnings and financial condition.

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## ***Additional information***

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### **Risk factors** continued

The RBS Group's results could be adversely affected in the event of goodwill impairment

The RBS Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the RBS Group tests goodwill for impairment annually, or more frequently when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of the value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. At 31 December 2013, the RBS Group carried goodwill of £10.1 billion on its balance sheet. The value in use and fair value of the RBS Group's cash generating units are affected by market conditions and the performance of the economies in which the RBS Group operates. Where the RBS Group is required to recognise a goodwill impairment, it is recorded in the RBS Group's income statement, although it has no effect on the RBS Group's regulatory capital position. Any significant write-down of goodwill could have a material adverse effect on the RBS Group's results of operations.

The recoverability of certain deferred tax assets recognised by the RBS Group depends on the RBS Group's ability to generate sufficient future taxable profits

In accordance with IFRS, the RBS Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The deferred tax assets are quantified on the basis of current tax legislation and accounting standards and are subject to change in respect of the future rates of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation or accounting standards may reduce the recoverable amount of the recognised deferred tax assets. In April 2011, the UK Government commenced a staged reduction in the rate of UK corporation tax from 28% to 23% over a four-year period and further rate reductions were announced in 2012 and 2013 which will lead to a corporation tax rate of 20% by April 2015. Such changes in the applicable tax rates will reduce the recoverable amount of the recognised deferred tax assets.

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## Glossary of terms

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

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

**Asset-backed securities (ABS)** - securities that represent interests in specific portfolios of assets. They are issued by a structured entity following a securitisation. The underlying portfolios commonly comprise residential or commercial mortgages but can include any class of asset that yields predictable cash flows. Payments on the securities depend primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as guarantees or other credit enhancements. Collateralised debt obligations, collateralised loan obligations, commercial mortgage backed securities and residential mortgage backed securities are all types of ABS.

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

**Assets under management** - assets managed by the Group on behalf of clients.

**Back-testing** - statistical techniques that assess the performance of a model, and how that model would have performed had it been applied in the past.

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

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

**Basis point** - one hundredth of a per cent i.e. 0.01 per cent. 100 basis points is 1 per cent. Used when quoting movements in interest rates or yields on securities.

**Bear steepener** - a steepening of the yield curve caused by long-term rates increasing faster than short term rates.

**BIPRU** - the prudential sourcebook for banks, building societies and investment firms. The part of the Financial Conduct Authority's (FCA) Handbook that sets out detailed prudential requirements for the banks that they regulate.

**Bull flattener** - a flattening of the yield curve in which long term rates are decreasing faster than short term rates.

**Buy-to-let mortgages** - mortgages to customers for the purchase of residential property as a rental investment.

**Capital requirements regulation (CRR)** - see CRD IV.

**Central counterparty (CCP)** - an intermediary between a buyer and a seller (generally a clearing house).

**Certificates of deposit (CDs)** - bearer negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.

**Collateralised debt obligations (CDOs)** - asset-backed securities for which the underlying asset portfolios are debt obligations: either bonds (collateralised bond obligations) or loans (collateralised loan obligations) or both. The credit exposure underlying synthetic CDOs derives from credit default swaps. The CDOs issued by an individual vehicle are usually divided in different tranches: senior tranches (rated AAA), mezzanine tranches (AA to BB), and equity tranches (unrated). Losses are borne first by the equity securities, next by the junior securities, and finally by the senior securities; junior tranches offer higher coupons (interest payments) to compensate for their increased risk.

**Collateralised loan obligations (CLOs)** - asset-backed securities for which the underlying asset portfolios are loans, often leveraged loans.

**Collectively assessed loan impairment provisions** - impairment loss provisions in respect of impaired loans, such as credit cards or personal loans, that are below individual assessment thresholds. Such provisions are established on a portfolio basis, taking account of the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends.

**Commercial mortgage backed securities (CMBS)** - asset-backed securities for which the underlying asset portfolios are loans secured on commercial real estate.

**Commercial paper (CP)** - unsecured obligations issued by a corporate or a bank directly or secured obligations (asset-backed CP), often issued through a commercial paper conduit, to fund working capital. Maturities typically range from two to 270 days. However, the depth and reliability of some CP markets means that issuers can repeatedly roll over CP issuance and effectively achieve longer term funding. CP is issued in a wide range of denominations and can be either discounted or interest-bearing.

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

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## Glossary of terms

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**Commercial real estate** - freehold and leasehold properties used for business activities. Commercial real estate includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, agricultural land and buildings, warehouses, garages etc.

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

**Constant currency** - reported results for the current reporting period are compared to results for comparative periods retranslated at exchange rates for the current period.

**Contractual maturity** - the date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.

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

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

**Cost:income ratio** - operating expenses as a percentage of total income.

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

**Coverage ratio** - impairment provisions as a percentage of impaired loans.

**Covered bonds** - debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds.

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

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

**Credit derivatives** - contractual agreements that provide protection against a credit event on one or more reference entities or financial assets. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence, if any, of a credit event. Credit derivatives include credit default swaps, total return swaps and credit swap options.

**Credit derivative product company (CDPC)** - a structured entity that sells credit protection under credit default swaps or certain approved forms of insurance policies. Sometimes they can also buy credit protection. CDPCs are similar to monoline insurers. However, unlike monoline insurers, they are not regulated as insurers.

**Credit enhancements** - techniques that improve the credit standing of financial obligations; generally those issued by a structured entity in a securitisation. External credit enhancements include financial guarantees and letters of credit from third-party providers. Internal enhancements include excess spread - the difference between the interest rate received on the underlying portfolio and the coupon on the issued securities; and over-collateralisation - on securitisation, the value of the underlying portfolio is greater than the securities issued.

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

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

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

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

**Currency swap** - an arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.

**Customer accounts** - money deposited with the Group by counterparties other than banks and classified as liabilities. They include demand, savings and time deposits; securities sold under repurchase agreements; and other short term deposits. Deposits received from banks are classified as deposits by banks.



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## Glossary of terms

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**Debit valuation adjustment (DVA)** - an adjustment made by an entity to the valuation of OTC derivative liabilities to reflect within fair value the entity's own credit risk.

**Debt securities** - transferable instruments creating or acknowledging indebtedness. They include debentures, bonds, certificates of deposit, notes and commercial paper. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue, such as the right to receive certain information. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured or unsecured.

**Debt securities in issue** - unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.

**Deferred tax asset** - income taxes recoverable in future periods as a result of deductible temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry-forward of tax losses and unused tax credits.

**Deferred tax liability** - income taxes payable in future periods as a result of taxable temporary differences (temporary differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

**Defined benefit obligation** - the present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.

**Defined benefit plan/scheme** - pension or other post-retirement benefit plan other than a defined contribution plan.

**Defined contribution plan/scheme** - pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.

**Deposits by banks** - money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, securities sold under repurchase agreements, federal funds purchased and other short term deposits. Deposits received from customers are recorded as customer accounts.

**Derivative** - a contract or agreement whose value changes with changes in an underlying index such as interest rates, foreign exchange rates, share prices or indices and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are: swaps, forwards, futures and options.

**Discontinued operation** - a component of the Group that either has been disposed of or is classified as held for sale. A discontinued operation is either: a separate major line of business or geographical area of operations or part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or a subsidiary acquired exclusively with a view to resale.

**Economic capital** - an internal measure of the capital required by the Group to support the risks to which it is exposed.

**Economic profit** - the difference between the return on shareholders funds and the cost of that capital. Economic profit is usually expressed as a percentage.

**Effective interest rate method** - the effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

**Encumbrance** - an interest in an asset held by another party. Encumbrance usually impacts the transferability of the asset and can restrict its free use until the encumbrance is removed.

**Equity risk** - the risk of changes in the market price of the equities or equity instruments arising from positions, either long or short, in equities or equity-based financial instruments.

**Eurozone** - the 17 European Union countries that have adopted the euro: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, The Netherlands, Portugal, Slovakia, Slovenia and Spain.

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

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

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

**FICO score** - a credit score calculated using proprietary software developed by the Fair Isaac Corporation in the US from a consumer's credit profile. The scores range between 300 and 850 and are used in credit decisions made by banks and other providers of credit.

**Financial Conduct Authority (FCA)** - the statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.

**Financial Services Compensation Scheme (FSCS)** - the UK's statutory fund of last resort for customers of authorised financial services firms. It pays compensation if a firm is unable to meet its obligations. The FSCS funds compensation for customers by raising management expenses levies and compensation levies on the financial services industry.

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## Glossary of terms

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**First/second lien** - a lien is a charge such as a mortgage held by one party, over property owned by a second party, as security for payment of some debt, obligation, or duty owed by that second party. The holder of a first lien takes precedence over all other encumbrances on that property i.e. second and subsequent liens.

**Forbearance** - forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

**Forward contract** - a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, at an agreed future date.

**Fully loaded Basel III basis** - capital ratios based on the rules that will apply at the end of the Basel III transition period.

**Futures contract** - a contract which provides for the future delivery (or acceptance of delivery) of some type of financial instrument or commodity under terms established at the outset. Futures differ from forward contracts in that they are traded on recognised exchanges and rarely result in actual delivery; most contracts are closed out prior to maturity by acquisition of an offsetting position.

**G10** - the Group of Ten comprises the eleven industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States) that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.

**Government Sponsored Enterprises (GSEs)** - a group of financial services corporations created by the US Congress. Their function is to improve the efficiency of capital markets and to overcome statutory and other market imperfections which otherwise prevent funds from moving easily from suppliers of funds to areas of high loan demand. They include the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

**Gross yield** - the interest rate earned on average interest-earning assets i.e. interest income divided by average interest-earning assets.

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

**Hedge funds** - pooled investment vehicles that are not widely available to the public; their assets are managed by professional asset managers who participate in the performance of the fund.

**Impaired loans** - all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

**Impairment allowance** - see Loan impairment provisions.

**Impairment losses** - (a) for impaired financial assets measured at amortised cost, impairment losses - the difference between carrying value and the present value of estimated future cash flows discounted at the asset's original effective interest rate - are recognised in profit or loss and the carrying amount of the financial asset reduced by establishing a provision (allowance) (b) for impaired available-for-sale financial assets, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss as an impairment loss.

**Individual liquidity guidance (ILG)** - guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.

**Individually assessed loan impairment provisions** - impairment loss provisions for individually significant impaired loans assessed on a case-by-case basis, taking into account the financial condition of the counterparty and any guarantor and the realisable value of any collateral held.

**Interest rate swap** - a contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.

**Interest spread** - the difference between the gross yield and the interest rate paid on average interest-bearing liabilities.

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

**Internal funding of trading business** - the internal funding of the trading book comprises net banking book financial liabilities that fund financial assets in the Group's trading portfolios. Interest payable on these financial liabilities is charged to the trading book.

**International Accounting Standards Board (IASB)** - the independent standard-setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.

**International Swaps and Derivatives Association (ISDA) master agreement** - a standardised contract developed by ISDA for bilateral derivatives transactions. The contract grants legal rights of set-off for derivative transactions with the same counterparty.

**Investment grade** - generally represents a risk profile similar to a rating of BBB-/Baa3 or better, as defined by independent rating agencies.

**Key management** - directors of RBSG and members of the Group Management Committee.

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

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## Glossary of terms

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**Level 1** - level 1 fair value measurements are derived from quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

**Level 2** - level 2 fair value measurements use inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly.

**Level 3** - level 3 fair value measurements use one or more unobservable inputs for the asset or liability.

**Leverage ratio** - a measure prescribed under Basel III. It is the ratio of tier 1 capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives, and generally follow the accounting measure of exposure.

**Leveraged finance** - funding (leveraged finance) provided to a business resulting in an overall level of debt in relation to cash flow that exceeds that which would be considered usual for the business or for the industry in which it operates. Leveraged finance is commonly employed to achieve a specific, often temporary, objective: to make an acquisition, to effect a buy-out or to repurchase shares.

**Liquidity and funding risk** - the risk that the Group is unable to meet its financial liabilities when they fall due.

**Liquidity coverage ratio (LCR)** - the ratio of the stock of high quality liquid assets to expected net cash outflows over the following 30 days. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, central bank eligible.

**Loan:deposit ratio** - the ratio of loans and advances to customers net of provision for impairment losses and excluding reverse repurchase agreements to customer deposits excluding repurchase agreements.

**Loan impairment provisions** - loan impairment provisions are established to recognise incurred impairment losses on a portfolio of loans classified as loans and receivables and carried at amortised cost. It has three components: individually assessed loan impairment provisions, collectively assessed loan impairment provisions and latent loss provisions.

**Loan-to-value ratio** - the amount of a secured loan as a percentage of the appraised value of the security e.g. the outstanding amount of a mortgage loan as a percentage of the property's value.

**London Interbank Offered Rate (LIBOR)** - the benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.

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

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

**Master netting agreement** - an agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

**Medium term notes (MTNs)** - debt securities usually with a maturity of five to ten years, but the term may be less than one year or as long as 50 years. They can be issued on a fixed or floating coupon basis or with an exotic coupon; with a fixed maturity date (non-callable) or with embedded call or put options or early repayment triggers. MTNs are generally issued as senior unsecured debt.

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

**Mortgage-backed securities** - asset-backed securities for which the underlying asset portfolios are loans secured on property. See Residential mortgage backed securities and Commercial mortgage backed securities.

**Mortgage servicing rights** - the rights of a mortgage servicer to collect mortgage payments and forward them, after deducting a fee, to the mortgage lender.

**Negative equity mortgages** - mortgages where the value of the property mortgaged is less than the outstanding balance on the loan.

**Net interest income** - the difference between interest receivable on financial assets classified as loans and receivables or available-for-sale and interest payable on financial liabilities carried at amortised cost.

**Net interest margin** - net interest income as a percentage of average interest-earning assets.

**Net stable funding ratio (NSFR)** - the ratio of available stable funding to required stable funding over a one year time horizon, assuming a stressed scenario. Available stable funding includes items such as equity capital, preferred stock with a maturity of over one year and liabilities with an assessed maturity of over one year.

**Non-performing loans** - loans classified as Risk elements in lending and Potential problem loans. They have a 100% probability of default and have been assigned an AQ10 internal credit grade.

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

**Option** - an option is a contract that gives the holder the right but not the obligation to buy (or sell) a specified amount of the underlying physical or financial commodity, at a specific price, at an agreed date or over an agreed period. Options can be exchange-traded or traded over-the-counter.

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



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## Glossary of terms

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*Own credit adjustment (OCA)* - the effect of the Group's own credit standing on the fair value of financial liabilities.

*Past due* - a financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.

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

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

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

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

*Potential future exposure* - is a measure of counterparty risk/credit risk. It is calculated by evaluating existing trades done against the possible market prices in future during the lifetime of the transactions.

*Potential problem loans (PPL)* - loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

*Private equity investments* - equity investments in operating companies not quoted on a public exchange. Capital for private equity investment is raised from retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.

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

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

*Regular way purchase or sale* - a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

*Regulatory capital* - the amount of capital that the Group holds, determined in accordance with rules established by the PRA for the consolidated Group and by local regulators for individual Group companies.

*Repurchase agreement (Repo)* - see Sale and repurchase agreements.

*Residential mortgage* - a loan to purchase a residential property where the property forms collateral for the loan. The borrower gives the lender a lien against the property and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms. Also known as a home loan.

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

*Retail loans* - loans made to individuals rather than institutions. The loans may be for car purchases, home purchases, medical care, home repair, holidays and other consumer uses.

*Return on equity* - profit attributable to ordinary and B shareholders divided by average shareholders' equity as a percentage.

*Reverse repurchase agreement (Reverse repo)* - see Sale and repurchase agreements.

*Risk appetite* - an expression of the maximum level of risk that the Group is prepared to accept to deliver its business objectives.

*Risk asset ratio (RAR)* - total regulatory capital as a percentage of risk-weighted assets.

*Risk elements in lending (REIL)* - impaired loans and accruing loans which are contractually overdue 90 days or more as to principal or interest.

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

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

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

*Settlement balances* - payables and receivables that result from purchases and sales of financial instruments recognised on trade date. Asset settlement balances are amounts owed to the Group in respect of sales and liability settlement balances are amounts owed by the Group in respect of purchases.

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## Glossary of terms

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**Sovereign exposures** - exposures to governments, ministries, departments of governments and central banks.

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

**Standstill** - is an agreement, usually for a specified period of time, not to enforce the Bank's rights as a result of a customer breaching the terms and conditions of their facilities. This is a concession to the customer. A standstill is most commonly used in a complex restructuring of a company's debts, where a group of creditors agree to delay enforcement action to give the company time to gather information and formulate a strategy with a view to establishing a formal restructuring.

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

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

**Structured credit portfolio (SCP)** - a portfolio of certain of the Group's illiquid assets - principally CDO super senior positions, negative basis trades and monoline exposures - held within Non-Core division.

**Structured entity (SE)** - an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity, for example when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. SEs are usually established for a specific, limited purpose, they do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions.

**Structured notes** - securities that pay a return linked to the value or level of a specified asset or index. Structured notes can be linked to equities, interest rates, funds, commodities and foreign currency.

**Subordinated liabilities** - liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.

**Super senior CDO** - the most senior class of instrument issued by a CDO vehicle. They benefit from the subordination of all other instruments, including AAA rated securities, issued by the CDO vehicle.

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

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

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

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

**Unaudited** - financial information that has not been subjected to the audit procedures undertaken by the Group's auditors to enable them to express an opinion on the Group's financial statements.

**US Federal Agencies** - are independent bodies established by the US Government for specific purposes such as the management of natural resources, financial oversight or national security. A number of agencies, including, the Government National Mortgage Association, issue or guarantee publicly traded debt securities.

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

**Wholesale funding** - wholesale funding comprises Deposits by banks, Debt securities in issue and Subordinated liabilities.

**Write-down** - a reduction in the carrying value of an asset to record a decline in its fair value or value in use.

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

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## *Forward looking statements*

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

In particular, this document includes forward-looking statements relating, but not limited to: the RBS Group's and the Group's restructuring and new strategic plans, divestments, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), profitability, cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; discretionary coupon and dividend payments; implementation of legislation of ring-fencing and bail-in measures; sustainability targets; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; and the Group's exposure to political risks, including the referendum on Scottish independence, credit rating risk and to various types of market risks, such as interest rate risk, foreign exchange rate risk and commodity and equity price risk. These statements are based on current plans, estimates and projections, and are subject to inherent risks, uncertainties and other factors which could cause actual results to differ materially from the future results expressed or implied by such forward-looking statements. For example, certain market risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: global economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the simplification of the Group's structure, the divestment of RBS Citizens Financial Group and the exiting of assets in RBS Capital Resolution as well as the disposal of certain other assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislation and regulation in the United Kingdom (UK), the European Union (EU) and the United States (US);

the implementation of key legislation and regulation including the UK Financial Services (Banking Reform Act) 2013 and the proposed EU Recovery and Resolution Directive; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of LIBOR and other interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the RBS Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees and maintain good employee relations; regulatory or legal changes (including those requiring any restructuring of the Group's operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the RBS Group; reputational risk; the conversion of the B Shares issued by RBS Group in accordance with their terms; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in the RBS Group; and the success of the Group in managing the risks involved in the foregoing.

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

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

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## Principal offices

### The Royal Bank of Scotland plc

PO Box 1000 Gogarburn Edinburgh EH12 1HQ

280 Bishopsgate London EC2M 4RB

### National Westminster Bank Plc

135 Bishopsgate London EC2M 3UR

### RBS Citizens

RBS Citizens Financial Group, Inc.

One Citizens Plaza Providence RI 02903 USA

### Ulster Bank

11-16 Donegall Square East Belfast BT1 5UB

George's Quay Dublin 2

### RBS Holdings USA Inc.

600 Washington Blvd Stamford CT 06901 USA

### Coutts Group

440 Strand London WC2R 0QS

### The Royal Bank of Scotland International Limited

Royal Bank House 71 Bath Street

St Helier Jersey Channel Islands JE4 8PJ