ROYAL BANK OF SCOTLAND GROUP PLC
Form 6-K
August 10, 2012

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For August 10, 2012

Commission File Number: 001-10306

The Royal Bank of Scotland Group plc

RBS, Gogarburn, PO Box 1000
Edinburgh EH12 1HQ

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.
Form 20-F __X__ Form 40-F _____

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes _____ No __X_–_

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-_____

This report on Form 6-K shall be deemed incorporated by reference into the company's Registration Statement on Form F-3 (File Nos. 333-162219 and 333-162219-01) and to be a part thereof from the date which it was filed, to the extent not superseded by documents or reports subsequently filed or furnished.

Presentation of information

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

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

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

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

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

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

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

On 6 February 2010, the businesses of ABN AMRO Holding N.V. acquired by the Dutch State were legally demerged to a newly established company, ABN AMRO Bank N.V., which on 1 April 2010 was transferred to ABN AMRO Group N.V., itself owned by the Dutch State. Following legal separation, RBS Holdings N.V. (formerly ABN AMRO Holding N.V.) has one operating subsidiary, The Royal Bank of Scotland N.V. (“RBS N.V.”), a fully operational bank within the Group. RBS N.V. is independently rated and regulated by the Dutch Central Bank. Certain assets within RBS N.V. continue to be shared by the Consortium Members.

On 19 April 2011, the Group announced the proposed transfers of a substantial part of the business activities of RBS N.V. to the Royal Bank. Subject to, among other matters, regulatory and other approvals and procedures, it is expected that the transfers will be implemented on a phased basis over a period ending 31 December 2013. A large part of the transfers is expected to have taken place by the end of 2012.

On 17 October 2011, the Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank pursuant to Part VII of the UK Financial Services and Markets Act 2000.

Approximately 98% of the issued share capital of RFS Holdings B.V. is held by the Group.

Non-GAAP financial information

The directors manage the Group's performance by class of business, before certain reconciling items, as is presented in the segmental analysis on pages 371 to 375 (the "managed basis"). Discussion of the Group's performance focuses on the managed basis as the Group believes that such measures allow a more meaningful analysis of the Group's financial condition and the results of its operations. These measures are non-GAAP financial measures. A body of generally accepted accounting principles such as IFRS is commonly referred to as 'GAAP'. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Reconciliations of these non-GAAP measures are presented throughout this document or in the segmental analysis on pages 371 to 375. These non-GAAP financial measures are not a substitute for GAAP measures. Furthermore, RBS has divided its operations into "Core" and "Non- Core". Certain measures disclosed in this document for Core operations and used by RBS management are non-GAAP financial measures as they represent a combination of all reportable segments with the exception of Non-Core. In addition, RBS has further divided parts of the Core business into "Retail & Commercial" consisting of the UK Retail, UK Corporate, Wealth, International Banking, Ulster Bank and US Retail & Commercial divisions. This is a non-GAAP financial measure. Lastly, the Basel III net stable funding ratio (see page 81) represents a non-GAAP financial measure given it is a metric that is not yet required to be disclosed by a government, governmental authority or self-regulatory organisation.

Glossary

A glossary of terms is provided on pages 440 to 447.

Forward-looking statements

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

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

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: the 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 access sufficient sources of liquidity and funding; the recommendations made by the Independent Commission on Banking (ICB) and their potential implications; the ability to implement strategic plans on a timely basis, or at all, including the disposal of certain Non-Core assets and assets and businesses required as part of the State Aid restructuring plan; organisational restructuring, including any adverse consequences of a failure to transfer, or delay in transferring, certain business assets and liabilities from RBS N.V. to RBS; the full nationalisation of the Group or other resolution procedures under the Banking Act 2009; deteriorations in borrower and counterparty credit quality; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the United States; the 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; ineffective management of capital or changes to capital adequacy or liquidity requirements; litigation and regulatory investigations; 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; regulatory or legal changes (including those requiring any restructuring of the Group’s operations) in the United Kingdom, the United States and other countries in which the Group operates or a change in United Kingdom Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of 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 Group; insurance claims; reputational risk; the ability to access the contingent capital arrangements with HM Treasury; the participation of the Group in the APS and the effect of the APS on the Group’s financial and capital position; the conversion of the B Shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group’s activities as a result of HM Treasury’s investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

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

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

Explanatory note

Divisional reorganisation and Group reporting changes

The company is filing this Form 6-K to restate certain segmental disclosures that were made in the company's annual report on Form 20-F for the year ended 31 December 2011, filed with the Securities and Exchange Commission on 27 March 2012 (the "2011 Form 20-F") to reflect the Group's new organisational structure, the revised allocation of Group Treasury costs, and the revised divisional return on equity ratios, and to combine movements in the fair value of own derivative liabilities, previously incorporated within Markets' operating performance, with changes in the fair value of own debt, in a single measure Own Credit Adjustments.

The Group presented segmental disclosures that reflect the new organisational structure in its interim results for the half year ended 30 June 2012, which were filed with the Securities and Exchange Commission on a separate Form 6-K on 8 August 2012. To facilitate comparison with these interim results, the segmental disclosures in the 2011 Form 20-F have been restated in this Form 6-K.

Consolidating financial information

As a result of filing this Form 6-K, the Group has presented a statement of comprehensive income within the consolidating financial information note, for all applicable periods.

Share consolidation

Following approval at the Annual General Meeting of the Company held on 30 May 2012, an ordinary share sub-division and one-for-ten consolidation took effect on 6 June 2012. This resulted in the 59,554,319,127 ordinary shares of 25p each, in issue at the record date of 1 June 2012, being sub-divided and consolidated into 5,955,431,912 ordinary shares of £1 each. Consequently, the Group has also restated in this Form 6-K certain disclosures relating to or impacted by numbers of ordinary shares or share prices.

The Group presented disclosures that reflect the changes discussed above in its interim results, which were filed with the Securities and Exchange Commission on a separate Form 6-K on 8 August 2012. To facilitate comparison with these interim results, the disclosures included in the 2011 Form 20-F have been restated in this Form 6-K.

Accordingly, the following pages that correspond to the 2011 Form 20-F have been restated to reflect the amendments identified above.

Item 3 - Key information	
Pages 8-9	(Business review)
Pages 408-409	(Risk factors)
Item 4 - Information on the Company	
Pages 4-5	(Business review - Description of business)
Page 6	(Business review - Competition)
Page 102	(Risk and balance sheet management - Divisional analysis of credit risk assets)
Page 104	(Risk and balance sheet management - AQ credit risk assets)
Page 108	(Risk and balance sheet management - Commercial real estate)
Page 110	(Risk and balance sheet management - Commercial real estate - Maturity profile of portfolio)
Page 111	

Page 150	(Risk and balance sheet management - REIL by division)
Pages 162-163	(Risk and balance sheet management - Movement in loan impairment provisions)
Pages 171, 174	(Risk and balance sheet management - Country risk - key points)
Pages 188-190	(Risk and balance sheet management - Market risk)
Page 191	(Risk and balance sheet management - Trading VaR)
Page 194	(Risk and balance sheet management - Insurance risk)
Pages 205, 207	(Risk and balance sheet management - Asset Protection Scheme)

This Form 6-K includes items 3, 4, 5, 6, 7, 8, 9, 10, 11 and 18 from the 2011 Form 20-F in their entirety and also retains the page numbering in respect of items 3, 4, 5, 6, 7, 8, 9, 10, 11 and 18 for ease of reference.

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Description of business

Introduction

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

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

At 31 December 2011, HM Treasury’s holding in the company’s ordinary shares was 66.9% and its economic interest was 82.2%.

The Group had total assets of £1,506.9 billion and owners' equity of £74.8 billion at 31 December 2011. The Group's risk asset ratios at 31 December 2011, were a Total capital ratio of 13.8%, a Core Tier 1 capital ratio of 10.6% and a Tier 1 capital ratio of 13.0%.

Organisational change

In January 2012, the Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes saw the reorganisation of the Group’s wholesale businesses into ‘Markets’ and ‘International Banking’ and the exit and downsizing of selected activities. The changes ensure the wholesale businesses continue to deliver against the Group’s strategy.

The changes include an exit from cash equities, corporate brokering, equity capital markets and mergers and acquisitions businesses. Significant reductions in balance sheet, funding requirements and cost base in the remaining wholesale businesses will be implemented.

GBM and GTS divisions have been reorganised as follows:

- The ‘Markets’ business maintains its focus on fixed income, with strong positions in debt capital raising, securitisation, risk management, foreign exchange and rates. It will serve the corporate and institutional clients of all Group businesses.

- GBM's corporate banking business has been combined with the international businesses of the GTS arm into a new ‘International Banking’ unit and provides clients with a 'one-stop shop' access to the Group’s debt financing, risk management and payments services. This international corporate business will be self-funded through its stable corporate deposit base.

- The domestic small and mid-size corporates previously served within GTS is now managed within RBS's domestic corporate banking businesses in the UK, Ireland (Ulster Bank) and the US (US Retail & Commercial).

Our wholesale business retains its international footprint ensuring that it can serve our customers' needs globally. We believe, that despite current challenges to the sector, wholesale banking services can play a central role in supporting cross border trade and capital flows, financing requirements and risk management and we remain committed to this business.

Organisational structure and business overview

The Group's activities are organised on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile. UK Retail remains committed to delivering 'Helpful and Sustainable' banking and to the commitments set out in its Customer Charter - the results of which are externally assessed and published every six months.

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

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

International Banking serves the world's largest companies with a leading client proposition focused on financing, transaction services and risk management. International Banking serves as the delivery channel for Markets products to corporate clients and serves international subsidiaries of both International Banking and clients from 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 has a network of branches and operates in the personal and bancassurance sectors, and its Corporate Banking division, which provides services to business customers, corporate customers and institutional markets.

Business review continued

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

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

Markets is a leading origination, sales and trading business across debt finance, fixed income, currencies, investor products and equity derivatives. The division offers a unified service to the Group’s corporate and institutional clients. The Markets’ 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.

Direct Line Group provides a wide range of general insurance products to consumers through a number of well known brands including; Direct Line, Churchill and Privilege. It also provides insurance services via a number of partner brands. In the commercial sector, its NIG and Direct Line for Business operations provide insurance products for businesses via brokers or direct respectively. Through its international division, Direct Line Group sells general insurance, mainly motor, in Germany and Italy. In addition to insurance services, Direct Line Group continues to provide support and reassurance to millions of UK motorists through its Green Flag breakdown recovery service and stolen vehicle recovery and telematics business (Tracker). On 15 February 2012, a new corporate brand, Direct Line Group, was announced.

To comply with EC State Aid requirements, the Group has agreed to dispose of Direct Line Group. It continues to be reported as a separate operating segment rather than within the Non-Core division as its business is distinct from the activities of the Non-Core division.

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

Non-Core division manages separately assets that the Group intends to run off or dispose of. The division contains a range of businesses and asset portfolios primarily from the 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.

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

Business divestments
To comply with EC State Aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. This supplements the measures in the Strategic Plan previously announced by the Group. These include divesting Direct Line Group, 80.01% of GMS (completed in 2010) and substantially all of RBS Sempra Commodities JV business (largely completed in 2010), as well as divesting the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the Direct SME customers across the UK.

Recent developments

Share consolidation
Following approval at the Group's Annual General Meeting on 30 May 2012, the sub-division and consolidation of the Group's ordinary shares on a one-for-ten basis took effect on 6 June 2012.There was a corresponding change in the Group's share price to reflect this.

The Board believes that the consolidation will result in a more appropriate share price for a company of the Group's size in the UK market. It may also help reduce volatility, thereby enabling a more consistent valuation of the Group.

Liability management: Exchange offer
On 28 February 2012, The Royal Bank of Scotland plc announced an invitation to offer to exchange certain Canadian Dollar, Australian Dollar, US Dollar, Euro and Swiss Franc denominated subordinated notes for new Canadian Dollar, Australian Dollar, US Dollar, Euro and Swiss Franc denominated subordinated notes, due 2022 and callable 2017. The new notes, other than the Australian Dollar denominated new notes, were issued on 16 March 2012, and the Australian Dollar denominated new notes were issued on 19 March 2012, in each case under the £90,000,000,000 Euro Medium Term Note Programme of The Royal Bank of Scotland plc and The Royal Bank of Scotland Group plc.

Business review continued

National Loan Guarantee Scheme
On 20 March 2012, RBS agreed to participate in the National Loan Guarantee Scheme (the Scheme), pursuant to which The Commissioners of Her Majesty's Treasury (HM Treasury) have agreed to unconditionally and irrevocably guarantee the due payment of all sums due and payable by RBS under any senior unsecured notes issued by RBS in accordance with the terms of the Scheme in respect of which HM Treasury issues a Guarantee Certificate (as defined in a deed of guarantee dated 20 March 2012 (the "Deed of Guarantee")). The Guarantor's obligations in that respect, are contained in the Deed of Guarantee, the form of which is available at www.dmo.gov.uk.

2012 Budget
In the Budget statement on 21 March 2012, the Chancellor of the Exchequer announced a further reduction of 1% in the rate of corporation tax such that the rate will fall by 2% from 26% to 24% in April 2012, to 23% in April 2013 and to 22% in April 2014. It was also announced in the Budget statement that the full rate of the bank levy will increase to 0.105 per cent. from 1 January 2013.

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

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities. In asset finance, the Group competes with banks and 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. The ambitions of non-traditional players in the UK market remain strong, with new entrants active and potentially seeking to build their platforms by acquiring businesses made available through restructuring of incumbents. The Group distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

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.

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

Line Group also competes with local insurance companies in the direct motor insurance markets in Italy and Germany.

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

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

Risk factors

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 of the Business review (pages 58 to 207). 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 405 to 418.

- The Group's businesses, earnings and financial condition have been and will continue to be affected by geopolitical conditions, the global economy, the instability in the global financial markets and increased competition. Together with a perceived increased risk of default on the sovereign debt of certain European countries and unprecedented stresses on the financial system within the eurozone, these factors have resulted in significant changes in market conditions including interest rates, foreign exchange rates, credit spreads, and other market factors and consequent changes in asset valuations.

- The Group's ability to meet its obligations' including its funding commitments, depends on the Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise could adversely affect the Group's financial condition. Furthermore, the Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings.

- The Independent Commission on Banking has published its final report on competition and possible structural reforms in the UK banking industry. The Government has indicated that it supports and intends to implement the recommendations substantially as proposed which could have a material adverse effect on the Group.

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

- The occurrence of a delay in the implementation of (or any failure to implement) the approved proposed transfers of a substantial part of the business activities of RBS N.V. to the Royal Bank may have a material adverse effect on the Group.

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

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

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

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

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

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

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

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

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

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

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

Business review continued

Key financials

for the year ended 31 December	2011 £m	2010 £m	2009 £m
Total income	28,937	31,868	33,026
Operating loss before tax	(766)	(399)	(2,647)
Loss attributable to ordinary and B shareholders	(1,997)	(1,125)	(3,607)
Cost:income ratio	62%	57%	52%
Basic loss per ordinary and B share from continuing operations (pence) (1)	(18.5p)	(4.5p)	(63.1p)

at 31 December		2011 £m	2010 £m	2009 £m
Funded balance sheet (2)		977,249	1,026,499	1,255,032
Total assets		1,506,867	1,453,576	1,696,486
Loans and advances to customers		515,606	555,260	728,393
Deposits		611,759	609,483	756,346
Owners' equity		74,819	75,132	77,736
Risk asset ratios	- Core Tier 1	10.6%	10.7%	11.0%
	- Tier 1	13.0%	12.9%	14.1%
	- Total	13.8%	14.0%	16.1%

Notes:
(1) Adjusted for the sub-division and one-for-ten consolidation of ordinary shares, which took effect in June 2012.
(2) Funded balance sheet represents total assets less derivatives.

Overview of results

The results of RFS Holdings B.V., the entity that acquired ABN AMRO, are fully consolidated in the Group's financial statements. The interests of the State of the Netherlands and Santander in RFS Holdings are included in non-controlling interests. Legal separation of ABN AMRO Bank N.V. took place on 1 April 2010. As a result, RBS presents the interests of the Consortium Members in ABN AMRO as discontinued operations.

Summary consolidated income statement
for the year ended 31 December 2011

	2011 £m	2010 £m	2009 £m
Net interest income	12,679	14,209	13,388
Fees and commissions receivable	6,384	8,193	8,738
Fees and commissions payable	(1,460)	(2,211)	(2,790)
Other non-interest income	7,078	6,549	8,424
Insurance net premium income	4,256	5,128	5,266
Non-interest income	16,258	17,659	19,638
Total income	28,937	31,868	33,026
Operating expenses	(18,026)	(18,228)	(17,417)
Profit before insurance net claims and impairment losses	10,911	13,640	15,609
Insurance net claims	(2,968)	(4,783)	(4,357)
Impairment losses	(8,709)	(9,256)	(13,899)
Operating loss before tax	(766)	(399)	(2,647)
Tax (charge)/credit	(1,250)	(634)	429
Loss from continuing operations	(2,016)	(1,033)	(2,218)
Profit/(loss) from discontinued operations, net of tax	47	(633)	(105)
Loss for the year	(1,969)	(1,666)	(2,323)
Non-controlling interests	(28)	665	(349)
Other owners' dividends	—	(124)	(935)
Loss attributable to ordinary and B shareholders	(1,997)	(1,125)	(3,607)
Basic loss per ordinary and B share from continuing operations (1)	(18.5p)	(4.5p)	(63.1p)

Note:
(1) Adjusted for the sub-division and one-for-ten consolidation of ordinary shares, which took effect in June 2012.

Results summary
2011 compared with 2010
Operating profit
Group operating loss before tax for the year was £766 million compared with £399 million in 2010. Group operating profit on a managed basis was £1,824 million compared with £1,845 million in 2010. Adjusting for the impact of the disposal of GMS in 2010, which recorded an operating profit of £207 million, Group operating profit on a managed basis was up 11%. The improvement was driven by a strong Retail & Commercial (R&C) operating performance and the return to profit of Direct Line Group. Ulster Bank and Markets faced more difficult conditions, leaving total Core operating profit on a managed basis at £6,045 million. Non-Core operating loss in 2011 was 26% lower compared with 2010, despite the acceleration of disposals in the second half of the year.

Total income
Total income fell by 9% to £28,937 million, primarily reflecting lower net interest income, lower trading income in Markets and Non-Core and a fall in insurance net premium income.

Net interest income
Group net interest income fell 11% to £12,679 million largely driven by the run-off of balances and exit of higher margin and higher risk segments in Non-Core. Group NIM was 14 basis points lower, reflecting the cost of carrying a higher liquidity portfolio and by the impact of non-performing assets in the Non-Core division. However, R&C NIM

was up 6 basis points, with strengthening asset margins in the first half of the year offsetting the impact of a competitive deposit market.

Non-interest income

Non-interest income decreased to £16,258 million from £17,659 million in 2010. This included movements in the fair value of the Asset Protection Scheme resulting in a £906 million charge (2010 - £1,550 million), gain on redemption of own debt of £255 million (2010 - £553 million) and a gain in own credit adjustments of £1,914 million (2010 - £242 million gain). Excluding these items, non-interest income was down 19% primarily reflecting a reduction in income from trading activities and lower net fees and commissions.

Operating expenses

Operating expenses decreased to £18,026 million (2010 - £18,228 million). Operating expenses on a managed basis fell to £15,478 million from £16,710 million in 2010.

This decrease was primarily driven by cost savings achieved as a result of the cost reduction programme and Non-Core run-off, largely reflecting the disposal of RBS Sempra and specific country exits. Staff costs fell 9%, driven by lower Markets and International Banking variable compensation as a result of its decrease in revenues, and in Non-Core, given the impact of a 32% reduction in headcount and continued business disposals and country exits.

The Group cost:income ratio was 62% in 2011 compared with 57% in 2010.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, reduced by 38% to £2,968 million.

General insurance claims were £1,730 million lower, mainly due to the non-repeat of bodily injury reserve strengthening in 2010, de-risking of the motor book, more benign weather in 2011 and claims in Non-Core decreasing as legacy policies ran-off.

Impairment losses

Impairment losses were £8,709 million compared with £9,256 million in 2010, with Core loan impairments falling by £260 million and Non-Core by £1,557 million, despite continuing challenges in Ulster Bank and corporate real estate portfolios, partially offset by an impairment of £1,099 million and interest rate hedge adjustments on impaired available-for-sale Greek government bonds of £169 million.

Risk elements in lending represented 8.6% of gross loans and advances to customers excluding reverse repos at 31 December 2011 (2010 - 7.3%).

Provision coverage of risk elements in lending was 49% (2010 - 47%).

Tax

The tax charge was £1,250 million in 2011, compared with £634 million in 2010. The high tax charge in the year reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland and the Netherlands) and the effect of the two reductions of 1% in the rate of UK corporation tax enacted in March 2011 and July 2011 on the net deferred tax balance.

Earnings

Basic loss per ordinary and B share from continuing operations increased from a loss of 4.5p to a loss of 18.5p.

Business review continued

Results summary continued
2010 compared with 2009

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

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

Total income
Total income decreased 4% to £31,868 million in 2010 reflecting the return to more normal levels in Markets compared with the favourable market conditions seen in 2009. This was offset by good growth in Core Retail & Commercial and the improvement in Non-Core.

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

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

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

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

Impairment losses
Impairment losses were £9,256 million compared with £13,899 million in 2009, with Core impairments falling by £898 million and Non-Core by £3,745 million. The decrease reflects an overall improvement in the economic environment. Impairments fell in all businesses, except Ulster Bank, which has faced an economic environment that remains challenging.

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

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

Tax
The Group recorded a tax charge of £634 million in 2010, compared with a tax credit of £429 million in 2009.

Earnings
Basic loss per ordinary and B share from continuing operations improved from a loss of 63.1p to a loss of 4.5p.

Business review continued

Analysis of results
Net interest income

	2011	2010	2009
	£m	£m	£m
Interest receivable	21,410	22,776	33,836
Interest payable	(8,731)	(8,567)	(17,332)
Net interest income	12,679	14,209	16,504
	%		
Gross yield on interest-earning assets of the banking business (1)	3.24	3.30	3.76
Cost of interest-bearing liabilities of the banking business	(1.68)	(1.47)	(2.18)
Interest spread of the banking business (2)	1.56	1.83	1.58
Benefit from interest-free funds	0.36	0.23	0.25
Net interest margin of the banking business (3)	1.92	2.06	1.83
Yields, spreads and margins of the banking business	%	%	%
Gross yield (1)			
- Group	3.24	3.30	3.76
- UK	3.56	3.42	3.35
- Overseas	2.77	3.15	4.09
Interest spread (2)			
- Group	1.56	1.83	1.58
- UK	1.81	2.01	1.50
- Overseas	1.22	1.59	1.67
Net interest margin (3)			
- Group	1.92	2.06	1.83
- UK	2.07	2.22	1.81
- Overseas	1.70	1.84	1.85
The Royal Bank of Scotland plc base rate (average)	0.50	0.50	0.64
London inter-bank three month offered rates (average)			
- Sterling	0.87	0.70	1.21
- Eurodollar	0.33	0.34	0.69
- Euro	1.36	0.75	1.21

Notes:
(1) Gross yield is the interest earned on average interest-earning assets of the banking book.
(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.
(4) The analysis into UK and overseas has been compiled on the basis of location of office.
(5) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

Average balance sheet and related interest

		2011			2010		
		Average Balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets							
Loans and advances to banks	- UK	31,994	293	0.92	22,714	222	0.98
	- Overseas	41,840	404	0.97	30,148	369	1.22
Loans and advances to customers	- UK	294,301	12,105	4.11	310,712	11,989	3.86
	- Overseas	171,979	5,864	3.41	195,858	6,900	3.52
Debt securities	- UK	62,231	1,449	2.33	66,765	1,459	2.19
	- Overseas	58,773	1,295	2.20	63,334	1,837	2.90
Interest-earning assets	- UK	388,526	13,847	3.56	400,191	13,670	3.42
	- Overseas	272,592	7,563	2.77	289,340	9,106	3.15
Total interest-earning assets	- banking business	661,118	21,410	3.24	689,531	22,776	3.30
	- trading business	278,975			276,330		
Interest-earning assets		940,093			965,861		
Non-interest-earning assets (5)		595,062			706,343		
Total assets		1,535,155			1,672,204		
Percentage of assets applicable to overseas operations		40.2%			44.0%		
Liabilities							
Deposits by banks	- UK	17,224	242	1.41	21,816	334	1.53
	- Overseas	47,371	740	1.56	59,799	999	1.67
Customer accounts: demand deposits	- UK	112,522	664	0.59	120,796	621	0.51
	- Overseas	43,177	483	1.12	39,127	607	1.55
Customer accounts: savings deposits	- UK	76,719	1,177	1.53	68,142	935	1.37
	- Overseas	25,257	130	0.51	25,587	213	0.83
Customer accounts: other time deposits	- UK	39,672	481	1.21	39,934	431	1.08
	- Overseas	33,971	594	1.75	43,996	914	2.08
Debt securities in issue	- UK	108,406	2,606	2.40	111,277	2,212	1.99
	- Overseas	42,769	765	1.79	72,175	1,065	1.48
Subordinated liabilities	- UK	16,874	470	2.79	19,442	398	2.05
	- Overseas	5,677	270	4.76	8,714	19	0.22
Internal funding of trading business	- UK	(40,242)	149	(0.37)	(41,451)	(140)	0.34
	- Overseas	(8,783)	(40)	0.46	(6,864)	(41)	0.60
Interest-bearing liabilities	- UK	331,175	5,789	1.75	339,956	4,791	1.41
	- Overseas	189,439	2,942	1.55	242,534	3,776	1.56
Total interest-bearing liabilities	- banking business	520,614	8,731	1.68	582,490	8,567	1.47
	- trading business (5)	307,564			293,993		
Interest-bearing liabilities		828,178			876,483		

Non-interest-bearing liabilities:			
Demand deposits	- UK	46,495	46,692
	- Overseas	19,909	23,994
Other liabilities (5)		565,534	648,129
Owners' equity		75,039	76,906
Total liabilities and owners' equity		1,535,155	1,672,204
Percentage of liabilities applicable to overseas operations		37.1%	41.7%

For notes relating to this table refer to page 12.

Business review continued

Average balance sheet and related interest continued

		2009		
		Average balance £m	Interest £m	Rate %
Assets				
Loans and advances to banks	- UK	21,616	310	1.43
	- Overseas	32,367	613	1.89
Loans and advances to customers	- UK	333,230	11,940	3.58
	- Overseas	376,382	16,339	4.34
Debt securities	- UK	52,470	1,414	2.69
	- Overseas	84,822	3,220	3.80
Interest-earning assets	- UK	407,316	13,664	3.35
	- Overseas	493,571	20,172	4.09
Total interest-earning assets	- banking business	900,887	33,836	3.76
	- trading business (5)	291,092		
Interest-earning assets		1,191,979		
Non-interest-earning assets		831,501		
Total assets		2,023,480		
Percentage of assets applicable to overseas operations		47.4%		
Liabilities				
Deposits by banks	- UK	24,837	679	2.73
	- Overseas	104,396	2,362	2.26
Customer accounts: demand deposits	- UK	110,294	569	0.52
	- Overseas	82,177	1,330	1.62
Customer accounts: savings deposits	- UK	54,270	780	1.44
	- Overseas	83,388	2,114	2.54
Customer accounts: other time deposits	- UK	68,625	932	1.36
	- Overseas	71,315	2,255	3.16
Debt securities in issue	- UK	116,536	2,830	2.43
	- Overseas	117,428	2,500	2.13
Subordinated liabilities	- UK	26,053	834	3.20
	- Overseas	12,468	656	5.26
Internal funding of trading business	- UK	(60,284)	(317)	0.53
	- Overseas	(14,845)	(192)	1.29
Interest-bearing liabilities	- UK	340,331	6,307	1.85
	- Overseas	456,327	11,025	2.42
Total interest-bearing liabilities	- banking business	796,658	17,332	2.18
	- trading business (5)	331,380		
Interest-bearing liabilities		1,128,038		
Non-interest-bearing liabilities:				
Demand deposits	- UK	38,220		
	- Overseas	27,149		
Other liabilities (5)		772,770		
Owners' equity		57,303		

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

For notes relating to this table refer to page 12.

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

	2011 over 2010 Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m
Interest-earning assets			
Loans and advances to banks			
UK	86	(15)	71
Overseas	124	(89)	35
Loans and advances to customers			
UK	(652)	768	116
Overseas	(820)	(216)	(1,036)
Debt securities			
UK	(102)	92	(10)
Overseas	(125)	(417)	(542)
Total interest receivable of the banking business			
UK	(668)	845	177
Overseas	(821)	(722)	(1,543)
	(1,489)	123	(1,366)
Interest-bearing liabilities			
Deposits by banks			
UK	66	26	92
Overseas	197	62	259
Customer accounts: demand deposits			
UK	45	(88)	(43)
Overseas	(58)	182	124
Customer accounts: savings deposits			
UK	(125)	(117)	(242)
Overseas	3	80	83
Customer accounts: other time deposits			
UK	3	(53)	(50)
Overseas	189	131	320
Debt securities in issue			
UK	58	(452)	(394)
Overseas	494	(194)	300
Subordinated liabilities			
UK	58	(130)	(72)
Overseas	9	(260)	(251)
Internal funding of trading business			
UK	(4)	(285)	(289)
Overseas	10	(11)	(1)
Total interest payable of the banking business			
UK	101	(1,099)	(998)

Overseas	844	(10)	834
	945	(1,109)	(164)
Movement in net interest income			
UK	(567)	(254)	(821)
Overseas	23	(732)	(709)
	(544)	(986)	(1,530)

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Business review continued

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

	2010 over 2009 Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m
Interest-earning assets			
Loans and advances to banks			
UK	15	(103)	(88)
Overseas	(40)	(204)	(244)
Loans and advances to customers			
UK	(836)	885	49
Overseas	(6,776)	(2,663)	(9,439)
Debt securities			
UK	342	(297)	45
Overseas	(716)	(667)	(1,383)
Total interest receivable of the banking business			
UK	(479)	485	6
Overseas	(7,532)	(3,534)	(11,066)
	(8,011)	(3,049)	(11,060)
Interest-bearing liabilities			
Deposits by banks			
UK	75	270	345
Overseas	845	518	1,363
Customer accounts: demand deposits			
UK	(54)	2	(52)
Overseas	670	53	723
Customer accounts: savings deposits			
UK	(192)	37	(155)
Overseas	965	936	1,901
Customer accounts: other time deposits			
UK	336	165	501
Overseas	708	633	1,341
Debt securities in issue			
UK	123	495	618
Overseas	799	636	1,435
Subordinated liabilities			
UK	180	256	436
Overseas	152	485	637
Internal funding of trading business			
UK	(83)	(94)	(177)
Overseas	(75)	(76)	(151)
Total interest payable of the banking business			
UK	385	1,131	1,516
Overseas	4,064	3,185	7,249
	4,449	4,316	8,765

Movement in net interest income			
UK	(94)	1,616	1,522
Overseas	(3,468)	(349)	(3,817)
	(3,562)	1,267	(2,295)

Non-interest income

	2011	2010	2009
	£m	£m	£m
Fees and commissions receivable	6,384	8,193	8,738
Fees and commissions payable	(1,460)	(2,211)	(2,790)
Income from trading activities			
- managed basis	3,314	6,074	3,909
- Asset Protection Scheme	(906)	(1,550)	—
- own credit adjustments	293	(7)	(148)
	2,701	4,517	3,761
Gain on redemption of own debt	255	553	3,790
Other operating income (excluding insurance net premium income)			
- managed basis	2,525	1,059	690
- strategic disposals	(24)	171	132
- own credit adjustments	1,621	249	51
	4,122	1,479	873
Insurance net premium income	4,256	5,128	5,266
Total non-interest income	16,258	17,659	19,638

2011 compared with 2010

Non-interest income decreased by £1,401 million in 2011 principally driven by lower trading income in Markets and Non-Core and a fall in insurance net premium income, partially offset by a higher gain on movements in own credit adjustments.

Volatile market conditions led to a reduction in Markets trading income, driven by the deterioration in global credit markets as sovereign difficulties in the eurozone grew.

Non-Core trading losses increased by £704 million, reflecting costs incurred as part of the division's focus on reducing capital trading assets, with activity including the restructuring of monoline exposures, which mitigated both significant immediate and future regulatory uplifts in risk-weighted assets.

A gain in own credit adjustments of £1,914 million was recorded as a result of Group credit spreads widening, partially offset by the 2011 charges. This compares with a smaller gain of £242 million in 2010.

Insurance net premium income fell by 17% largely driven by Direct Line Group's exit from certain business segments, along with reduced volumes driven by the de-risking of the motor book. Insurance net premium income in Non-Core also decreased as legacy policies ran-off.

2010 results included £482 million of income recorded for GMS prior to its disposal in November 2010.

2010 compared with 2009

Net fees and commissions increased by £34 million to £5,982 million primarily due to improved performance in Markets (£173 million), driven by higher portfolio management and origination income, and UK Corporate (£123 million), principally reflecting strong refinancing levels and increased operating lease activity. This increase was partially offset by reduced fees in UK Retail (£160 million) and Ulster Bank (£73 million) principally reflecting the restructuring of current account overdraft fees.

Income from trading activities, excluding fair value movements in the Asset Protection Scheme, rose substantially during the year by £2,306 million to £6,067 million. Trading revenues in Markets were lower than 2009, which saw unusually buoyant market conditions as rapidly falling interest rates generated significant revenue opportunities. This was more than offset by the improvement in Non-Core trading losses from £5,122 million for 2009 to £16 million for 2010 as underlying asset prices recovered and monoline spreads tightened. The unwinding of some banking book hedges also helped reduce trading losses.

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

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

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

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

Business review continued

Operating expenses and insurance claims

	2011 £m	2010 £m	2009 £m
Staff costs			
- excluding gains on pensions curtailment	8,678	9,671	9,993
- gains on pensions curtailment	—	—	(2,148)
Premises and equipment	8,678	9,671	7,845
Other administrative expenses	2,451	2,402	2,594
- managed basis	2,722	2,963	3,163
- Payment Protection Insurance costs	850	—	—
- integration and restructuring costs	1,059	1,032	1,286
- bank levy	300	—	—
	4,931	3,995	4,449
Administrative expenses	16,060	16,068	14,888
Depreciation and amortisation	1,875	2,150	2,166
Write-down of goodwill and other intangible assets	91	10	363
Operating expenses	18,026	18,228	17,417
General insurance	2,968	4,698	4,223
Bancassurance	—	85	134
Insurance net claims	2,968	4,783	4,357
Staff costs as a percentage of total income	30%	30%	30%

2011 compared with 2010

Group operating expenses fell by 1% in 2011, driven by cost savings achieved as a result of the cost reduction programme and Non-Core run-off, largely reflecting the disposal of RBS Sempra and specific country exits, partially offset by Payment Protection Insurance costs.

Staff costs fell 10%, driven by lower Markets and International Banking discretionary compensation as a result of its decrease in revenues, and in Non-Core, given the impact of a 32% reduction in headcount and continued business disposals and country exits.

In May 2011, following the decision of the British Bankers' Association not to appeal the judgement of the judicial review, the Group recorded a provision of £850 million in respect of the costs of Payment Protection Insurance redress.

General insurance claims were £1,730 million lower, mainly due to the non-repeat of bodily injury reserve strengthening in 2010, de-risking of the motor book, more benign weather in 2011 and claims in Non-Core decreasing as legacy policies ran-off.

The Group's cost reduction programme delivered cost savings with an underlying run rate of over £3 billion by the end of 2011.

Business review continued

Operating expenses and insurance claims continued
2010 compared with 2009
The main driver of a 7% decrease in operating expenses, excluding gains on pensions curtailment of £2,148 million, is the recognition of benefits from the Group-wide efficiency programme. The programme continues to deliver material savings which have been funding investments to strengthen our Core franchises. Annualised savings are now just ahead of the £2.5 billion target for 2011 and are forecast to exceed £3 billion by 2013.

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

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

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

Insurance net claims increased 10% to £4,783 million.

Integration costs

	2011	2010	2009
	£m	£m	£m
Staff costs	38	210	365
Premises and equipment	6	3	78
Other administrative expenses	51	143	398
Depreciation and amortisation	11	20	18
	106	376	859

Note:
(1) Integration costs for 2011 above exclude £2 million charge included within net interest income and a loss of £3 million within other operating income in respect of integration activities.

2011 compared with 2010
Integration costs were £106 million compared with £376 million in 2010. Integration costs decreased primarily due to a reduction of RBS N.V. (formerly ABN AMRO) integration activity during the year.

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

Accruals in relation to integration costs are set out below.

	At 1 January 2011	Charge to income statement	Utilised during the year	At 31 December 2011
	£m	£m	£m	£m
Staff costs - redundancy	—	8	(8)	—
Staff costs - other	—	30	(30)	—
Premises and equipment	24	6	(19)	11

Other administrative expenses	—	51	(48)	3
Depreciation and amortisation	—	11	(11)	—
	24	106	(116)	14

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Business review continued

Restructuring costs

	2011	2010	2009
	£m	£m	£m
Staff costs	356	353	328
Premises and equipment	156	117	48
Other administrative expenses	276	104	51
	788	574	427

2011 compared with 2010
Restructuring costs were £788 million compared with £574 million in 2010. The increase is due to the number of Group restructuring projects increasing during the year.

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

Accruals in relation to restructuring costs are set out below.

	At 1 January 2011	Currency translation adjustments	Charge to income statement	Utilised during the year	At 31 December 2011
	£m	£m	£m	£m	£m
Staff costs - redundancy	201	—	274	(349)	126
Staff costs - other	17	(1)	82	(58)	40
Premises and equipment	117	—	156	(107)	166
Other administrative expenses	46	(2)	276	(210)	110
	381	(3)	788	(724)	442

Divestment costs

	2011	2010	2009
	£m	£m	£m
Staff costs	95	51	—
Premises and equipment	11	6	—
Other administrative expenses	59	25	—
	165	82	—

2011 compared with 2010
Divestment costs of £165 million compared to £82 million in 2010 related to the European Commission mandated divestments.

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

Accruals in relation to divestment costs are set out below.

At	Charge	Utilised	At

	1 January 2011	to income statement	during the year	31 December 2011
	£m	£m	£m	£m
Staff costs - redundancy	22	36	(13)	45
Staff costs - other	8	59	(66)	1
Premises and equipment	—	11	(11)	—
Other administrative expenses	2	59	(40)	21
	32	165	(130)	67

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Business review continued

Impairment losses

	2011 £m	2010 £m	2009 £m
New impairment losses	9,236	9,667	14,224
Less: recoveries of amounts previously written-off	(527)	(411)	(325)
Charge to income statement	8,709	9,256	13,899
Comprising:			
Loan impairment losses	7,241	9,144	13,090
Securities			
- managed basis	200	112	809
- sovereign debt impairment	1,099	—	—
- interest rate hedge adjustments on impaired available-for-sale sovereign debt	169	—	
	1,468	112	809
Charge to income statement	8,709	9,256	13,899

2011 compared with 2010

Impairment losses decreased by 6% compared with 2010, driven largely by a £1,569 million reduction in Non-Core loan impairments, despite continuing challenges in Ulster Bank and corporate real estate portfolios. This was partially offset by impairments taken on the Group's available-for-sale bond portfolio, as a result of the decline in the value of Greek sovereign bonds.

Retail & Commercial impairment losses fell by £227 million, driven by improving credit metrics in UK Retail and US Retail & Commercial partially offset by increases in Ulster Bank, largely reflecting a deterioration in credit metrics on the mortgage portfolio, and a single name provision in International Banking.

Total Core and Non-Core Ulster Bank impairment losses decreased by 4%, as the £223 million increase in Core Ulster Bank losses was more than offset by a decrease in losses recognised in Non-Core.

The Group holds Greek government bonds with a notional amount of £1.45 billion. As a result of Greece's continuing fiscal difficulties, the Group recorded impairment charges on these bonds totalling £1,099 million during the year. These charges were recorded to write the bonds down to their market price as at 31 December 2011 (c.21% of notional).

2010 compared with 2009

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

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

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

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

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

Business review continued

Tax

	2011	2010	2009
	£m	£m	£m
Tax (charge)/credit	(1,250)	(634)	429
	%	%	%
UK corporation tax rate	26.5	28.0	28.0
Effective tax rate	nm	nm	16.2

nm = not meaningful

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

	2011	2010	2009
	£m	£m	£m
Expected tax credit	203	112	741
Sovereign debt impairment where no deferred tax asset recognised	(275)	—	—
Other losses in year where no deferred tax asset recognised	(530)	(450)	(780)
Foreign profits taxed at other rates	(417)	(517)	(276)
UK tax rate change - deferred tax impact	(110)	(82)	—
Unrecognised timing differences	(20)	11	274
Non-deductible goodwill impairment	(24)	(3)	(102)
Items not allowed for tax			
- losses on strategic disposals and write-downs	(72)	(311)	(152)
- UK Bank levy	(80)	—	—
- employee share schemes	(113)	(32)	(29)
- other disallowable items	(271)	(296)	(327)
Non-taxable items			
- gain on sale of Global Merchant Services	12	221	—
- gain on redemption of own debt	—	11	693
- other non-taxable items	245	341	410
Taxable foreign exchange movements	4	4	1
Losses brought forward and utilised	2	2	94
Adjustments in respect of prior years	196	355	(118)
Actual tax (charge)/credit	(1,250)	(634)	429

2011 compared with 2010
The high tax charge in 2011 reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland and the Netherlands) and the effect of two reductions of 1% in the rate of UK corporation tax enacted in March 2011 and July 2011 on the net deferred tax balance.

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

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Business review continued

Divisional performance

Operating profit/(loss) by division	2011 £m	2010 £m	2009 £m
UK Retail	2,021	1,348	375
UK Corporate	1,924	1,893	1,392
Wealth	248	283	373
International Banking	755	1,311	1,118
Ulster Bank	(984)	(683)	(385)
US Retail & Commercial	537	349	(52)
Retail & Commercial	4,501	4,501	2,821
Markets	899	2,724	4,991
Direct Line Group	454	(295)	58
Central items	191	630	456
Core	6,045	7,560	8,326
Non-Core	(4,221)	(5,715)	(14,461)
Managed basis	1,824	1,845	(6,135)
Reconciling items			
Own credit adjustments	1,914	242	(97)
Asset Protection Scheme	(906)	(1,550)	—
Payment Protection Insurance costs	(850)	—	—
Sovereign debt impairment	(1,099)	—	—
Amortisation of purchased intangible assets	(222)	(369)	(272)
Integration and restructuring costs	(1,064)	(1,032)	(1,286)
Gain on redemption of own debt	255	553	3,790
Strategic disposals	(104)	171	132
Gains on pension curtailment	—	—	2,148
Bank levy	(300)	—	—
Write-down of goodwill and other intangible assets	(11)	(10)	(363)
Bonus tax	(27)	(99)	(208)
Interest rate hedge adjustments on impaired available-for-sale sovereign debt	(169)	—	—
RFS Holdings minority interest	(7)	(150)	(356)
Group operating loss before tax	(766)	(399)	(2,647)

	2011	2010	2009
Impairment losses/(recoveries) by division	£m	£m	£m
UK Retail	788	1,160	1,679
UK Corporate	793	767	936
Wealth	25	18	33
International Banking	168	86	418
Ulster Bank	1,384	1,161	649
US Retail & Commercial	326	519	705
Retail & Commercial	3,484	3,711	4,420
Markets	38	65	250
Direct Line Group	—	—	8
Central items	(2)	4	—
Core	3,520	3,780	4,678
Non-Core	3,919	5,476	9,221
Managed basis	7,439	9,256	13,899
Reconciling items			
Sovereign debt impairment	1,099	—	—
Interest rate hedge adjustments on impaired available-for-sale sovereign debt	169	—	—
RFS Holdings minority interest	2	—	—
Group impairment losses	8,709	9,256	13,899

	2011	2010	2009
Net interest margin by division	%	%	%
UK Retail	3.95	3.89	3.74
UK Corporate	3.06	2.89	2.53
Wealth	3.23	3.26	4.07
International Banking	1.73	1.92	1.86
Ulster Bank	1.87	2.03	1.83
US Retail & Commercial	3.06	2.82	2.34
Retail & Commercial	2.97	2.91	2.62
Non-Core	0.63	1.02	0.74
Group net interest margin	1.92	2.06	1.76

	2011	2010	2009
Risk-weighted assets by division	£bn	£bn	£bn
UK Retail	48.4	48.8	51.3
UK Corporate	79.3	84.2	92.5
Wealth	12.9	12.5	11.2
International Banking	43.2	51.7	67.7
Ulster Bank	36.3	31.6	29.9
US Retail & Commercial	59.3	57.4	60.1
Retail & Commercial	279.4	286.2	312.7
Markets	120.3	110.3	72.4
Other	12.0	18.0	9.4
Core	411.7	414.5	394.5
Non-Core	93.3	153.7	171.3
Group before benefit of Asset Protection Scheme	505.0	568.2	565.8
Benefit of Asset Protection Scheme	(69.1)	(105.6)	(127.6)

Group before RFS Holdings minority interest	435.9	462.6	438.2
RFS Holdings minority interest	3.1	2.9	102.8
Group	439.0	465.5	541.0

Business review continued

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

	2011	2010	2009
UK Retail	27,700	28,200	30,000
UK Corporate	13,600	13,200	12,400
Wealth	5,700	5,200	4,600
International Banking	5,400	5,300	6,800
Ulster Bank	4,200	4,200	4,500
US Retail & Commercial	15,400	15,900	15,700
Retail & Commercial	72,000	72,000	74,000
Markets	13,900	15,700	14,300
Direct Line Group	14,900	14,500	13,900
Central items	6,200	4,700	4,200
Core	107,000	106,900	106,400
Non-Core	4,700	6,900	15,100
	111,700	113,800	121,500
Business Services	34,000	34,400	38,600
Integration and restructuring	1,100	300	500
RFS Holdings minority interest	—	—	300
Group	146,800	148,500	160,900

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UK Retail

	2011	2010	2009
	£m	£m	£m
Net interest income	4,302	4,054	3,598
Net fees and commissions	1,066	1,100	1,244
Other non-interest income	140	322	391
Non-interest income	1,206	1,422	1,635
Total income	5,508	5,476	5,233
Direct expenses			
- staff	(839)	(889)	(968)
- other	(437)	(480)	(458)
Indirect expenses	(1,423)	(1,514)	(1,619)
	(2,699)	(2,883)	(3,045)
Profit before insurance net claims and impairment losses	2,809	2,593	2,188
Insurance net claims	—	(85)	(134)
Impairment losses	(788)	(1,160)	(1,679)
Operating profit	2,021	1,348	375
Analysis of income by product			
Personal advances	1,089	993	1,192
Personal deposits	961	1,102	1,349
Mortgages	2,277	1,984	1,214
Cards	950	962	869
Other, including bancassurance	231	435	609
Total income	5,508	5,476	5,233
Analysis of impairments by sector			
Mortgages	182	177	124
Personal	437	682	1,023
Cards	169	301	532
Total impairment losses	788	1,160	1,679
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	0.2%	0.2%	0.1%
Personal	4.3%	5.8%	7.5%
Cards	3.0%	4.9%	8.6%
Total	0.7%	1.1%	1.6%
Performance ratios			
Return on equity (1)	24.5%	16.3%	4.8%
Net interest margin	3.95%	3.89%	3.74%
Cost:income ratio	49%	53%	58%
Adjusted cost:income ratio (2)	49%	53%	60%
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross) (3)			
- mortgages	95.0	90.6	83.2

- personal	10.1	11.7	13.6
- cards	5.7	6.1	6.2
	110.8	108.4	103.0
Customer deposits (excluding bancassurance) (3)	101.9	96.1	87.2
Assets under management (excluding deposits)	5.5	5.7	5.3
Risk elements in lending (3)	4.6	4.6	5.7
Loan:deposit ratio (excluding repos)	106%	110%	115%
Risk-weighted assets	48.4	48.8	51.3

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

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

(3) Includes disposal groups: loans and advances to customers - £7.3 billion; customer deposits - £8.8 billion; risk elements in lending - £0.5 billion.

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Business review continued

UK Retail continued
In 2010, UK Retail set out an aspiration to become the UK's most helpful bank and launched the Customer Charter. In 2011, we made good progress on our Customer Charter commitments and the roll-out of innovation that actually helps customers. In December 2011, UK Retail refined its staff incentive scheme to further strengthen the role of customer service and to help build long lasting customer relationships.

Progress against the Customer Charter commitments is independently assessed and has shown encouraging results. By the end of 2011, we achieved the goal of serving 80% of our customers in less than 5 minutes in our busiest branches. Branch opening hours have also been extended and standardised, which means that our branches are now open for an additional 5,000 hours per week at times our customers have told us suit them.

Innovation has supported the delivery of Helpful Banking by focusing on solutions that make it easier for customers to bank with RBS and NatWest. An important example has been giving customers access to 24 hour emergency cash from NatWest and RBS ATMs when their cards are lost or stolen. We also updated our market-leading iPhone application and by the end of the year 1 million customers had downloaded the application. With successful apps also launched for iPad, Android and Blackberry, RBS is now the leading mobile bank in the UK.

2011 compared with 2010
UK Retail delivered strong full year results, as operating profit increased by £673 million to £2,021 million, despite continued uncertainty in the economic climate and the low interest rate environment. Impairments fell by £372 million, with further improvements in the unsecured book and continued careful mortgage underwriting. Return on equity improved to 24.5%.

The division continued to focus on growing secured lending while at the same time building customer deposits, thereby reducing the Group's reliance on wholesale funding. Loans and advances to customers grew 2%, with a change in mix from unsecured to secured as the Group actively sought to improve its risk profile. Mortgage balances grew by 5%, while unsecured lending contracted by 11%.

- Mortgage growth reflected continued strong new business levels. Gross mortgage lending market share of 10% continues above our stock position of 8%.

- Customer deposits grew 6%, outperforming the market total deposit growth of 3%. Savings balances grew by £6 billion, or 9%, with 1.5 million accounts opened, demonstrating the strength of our customer franchise and our strategy to further develop primary banking relationships.

Net interest income increased by 6% to £4,302 million, driven by strong balance sheet growth. Net interest margin decreased 6 basis points with recovering asset margins more than offset by more competitive savings rates and lower long term swap rate returns adversely impacting liability margins.

Non-interest income declined 15% to £1,206 million, primarily driven by lower investment and protection income as a result of the dissolution of the bancassurance joint venture. In addition, a number of changes have been made to support delivery of Helpful Banking, such as 'Act Now' text alerts, which have decreased fee income.

Overall expenses decreased by 6%, with the adjusted cost:income ratio improving from 53% to 49%. Cost reductions were driven by a clear management focus on process re-engineering and operational efficiency together with benefits from the dissolution of the bancassurance joint venture, partly offset by higher inflation rates in utility and mail costs.

Impairment losses decreased 32% to £788 million reflecting the impact of a strengthened risk appetite, and a more stable economic environment.

Risk-weighted assets were broadly stable, with volume growth in lower risk secured mortgages partly offset by a decrease in the unsecured portfolio.

2010 compared with 2009
Operating profit recovered strongly from the low levels recorded in 2008 and 2009 to £1,348 million and impairments fell by £519 million as the economic environment continued to recover.

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

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

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

Net interest income increased significantly by 13% to £4,054 million, driven by strong balance sheet growth and repricing. Net interest margin improved by 15 basis points to 3.89%, with widening asset margins partially offset by contracting liability margins in the face of a competitive deposit market.

Non-interest income declined 13% to £1,422 million, principally reflecting the restructuring of current account overdraft fees in the final quarter of 2009.

Expenses decreased by 5%, with the cost:income ratio (net of insurance claims) improving from 60% to 53%.

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

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

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

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

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

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

Business review continued

UK Corporate

	2011 £m	2010 £m	2009 £m
Net interest income	3,092	3,000	2,633
Net fees and commissions	1,375	1,353	1,230
Other non-interest income	396	443	499
Non-interest income	1,771	1,796	1,729
Total income	4,863	4,796	4,362
Direct expenses			
- staff	(922)	(912)	(882)
- other	(390)	(411)	(311)
Indirect expenses	(834)	(813)	(841)
	(2,146)	(2,136)	(2,034)
Profit before impairment losses	2,717	2,660	2,328
Impairment losses	(793)	(767)	(936)
Operating profit	1,924	1,893	1,392
Analysis of income by business			
Corporate and commercial lending	2,643	2,571	2,100
Asset and invoice finance	660	616	500
Corporate deposits	694	738	984
Other	866	871	778
Total income	4,863	4,796	4,362
Analysis of impairments by sector			
Banks and financial institutions	20	20	15
Hotels and restaurants	59	52	98
Housebuilding and construction	103	131	106
Manufacturing	34	1	51
Other	171	133	159
Private sector education, health, social work, recreational and community services	113	30	59
Property	170	245	259
Wholesale and retail trade, repairs	85	91	76
Asset and invoice finance	38	64	113
Total impairment losses	793	767	936
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Banks and financial institutions	0.3%	0.3%	0.2%
Hotels and restaurants	1.0%	0.8%	1.5%
Housebuilding and construction	2.6%	2.9%	2.5%
Manufacturing	0.7%	-	0.9%
Other	0.5%	0.4%	0.5%
Private sector education, health, social work, recreational and community services	1.3%	0.3%	0.9%
Property	0.6%	0.8%	0.8%
Wholesale and retail trade, repairs	1.0%	0.9%	0.7%
Asset and invoice finance	0.4%	0.6%	1.3%

Total	0.7%	0.7%	0.8%
Performance ratios			
Return on equity (1)	15.2%	13.6%	10.4%
Net interest margin	3.06%	2.89%	2.53%
Cost:income ratio	44%	45%	47%

Note:
(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

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	2011	2010	2009
	£bn	£bn	£bn
Capital and balance sheet			
Total third party assets	114.2	117.0	116.7
Loans and advances to customers (gross) (1)			
- banks and financial institutions	5.8	6.2	6.3
- hotels and restaurants	6.1	6.8	6.7
- housebuilding and construction	3.9	4.5	4.3
- manufacturing	4.7	5.4	6.0
- other	34.2	32.6	31.0
- private sector education, health, social work, recreational and community services	8.7	9.0	6.5
- property	28.2	29.5	33.0
- wholesale and retail trade, repairs	8.7	9.9	10.4
- asset and invoice finance	10.4	9.9	8.8
	110.7	113.8	113.0
Customer deposits (1)	126.3	124.5	110.8
Risk elements in lending (1)	5.0	4.0	2.3
Loan:deposit ratio (excluding repos)	86%	90%	101%
Risk-weighted assets	79.3	84.2	92.5

Note:
(1) Includes disposal groups: loans and advances to customers - £12.2 billion; customer deposits - £21.8 billion; risk elements in lending - £1.0 billion.

In 2011, UK Corporate focused on supporting its customers through challenging economic times. As a result of over 5,000 hours of customer research, UK Corporate launched the ‘Ahead for Business’ promise to its small and medium-sized enterprise (SME) customers.

To deliver on this, the division launched a number of initiatives to improve the service it offers to customers. For example, the ‘Working with You’ initiative, has seen over 4,600 visits to customer businesses since its launch in Q2 2011. Additionally, following the launch of the relationship manager accreditation programme, also in Q2 2011, almost all relationship managers have gained full accreditation in the initial phase.

UK Corporate continued to support new and existing businesses during 2011:
- launching its best ever fixed rate loan product for SMEs;
- reacting quickly after the August riots to give affected businesses access to special interest rate and fee free lending products;
- answering over 4,000 calls on the Start-up Hotline, offering free advice and a complementary business plan review service; and
- supporting more debt capital and loan market deals for larger corporates than any other bank.

The division also took measures to reduce the risk retained in the business allowing for quicker and more consistent decisions by
simplifying the credit underwriting process and improving automated decision making.

2011 compared with 2010
Operating profit increased 2% to £1,924 million, as higher income was only partially offset by higher impairments and an increase in expenses. Net interest income remained broadly flat. Net interest margin improved 17 basis points with benefits from re-pricing the lending portfolio and the revision to income deferral assumptions in Q1 2011 partially

offset by increased funding costs together with continued pressure on deposit margins. A 1% increase in deposit balances supported an improvement in the loan:deposit ratio to 86%.

Non-interest income decreased by 1% as a result of lower Markets cross-sales and fee income, partially offset by increased Invoice Finance and Lombard income.

Excluding the £29 million OFT penalty in 2010, total costs increased by 2%, largely reflecting increased investment in the business and higher costs of managing the non-performing book.

Impairments of £793 million were 3% higher due to increased specific impairments and collectively assessed provisions, partially offset by lower latent loss provisions.

2010 compared with 2009
Operating profit grew by £501 million, 36%, compared with 2009, driven by strong income growth and significantly lower impairments, partially offset by higher costs.

UK Corporate performed strongly in the deposit market, with customer deposit balance growth of £14 billion contributing to a 11 percentage point improvement in the loan:deposit ratio in 2010. While customer lending increased only marginally (with gross lending largely offset by customer deleveraging) net interest income rose by £367 million, 14%, and net interest margin rose by 36 basis points driven primarily by the good progress made on loan repricing.

Non-interest income increased 4% reflecting strong refinancing levels and increased operating lease activity, partially offset by lower sales of financial market products.

Total costs increased 5% (£102 million) or 4% excluding the OFT penalty in 2010.

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

Return on equity increased from 10.4% to 13.6%, reflecting higher operating profit and lower RWAs as a result of improved risk metrics.

Business review continued

Wealth

	2011	2010	2009
	£m	£m	£m
Net interest income	645	588	616
Net fees and commissions	375	376	363
Other non-interest income	84	71	83
Non-interest income	459	447	446
Total income	1,104	1,035	1,062
Direct expenses			
- staff	(413)	(382)	(357)
- other	(195)	(142)	(144)
Indirect expenses	(223)	(210)	(155)
	(831)	(734)	(656)
Profit before impairment losses	273	301	406
Impairment losses	(25)	(18)	(33)
Operating profit	248	283	373
Analysis of income			
Private banking	902	836	869
Investments	202	199	193
Total income	1,104	1,035	1,062
Performance ratios			
Return on equity (1)	13.1%	15.9%	24.8%
Net interest margin	3.23%	3.26%	4.07%
Cost:income ratio	75%	71%	62%

	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	8.3	7.8	6.5
- personal	6.9	6.7	4.9
- other	1.7	1.6	2.3
	16.9	16.1	13.7
Customer deposits (2)	38.2	37.1	35.7
Assets under management (excluding deposits) (2)	30.9	33.9	32.5
Risk elements in lending	0.2	0.2	0.2
Loan:deposit ratio (excluding repos) (2)	44%	43%	38%
Risk-weighted assets	12.9	12.5	11.2

Notes:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) 2010 and 2009 comparatives have been revised to reflect the current reporting methodology.

2011 has been a significant year for the Coutts businesses from a strategic perspective. In Q1 2011, a new divisional strategy was
defined with the execution of early changes already making an impact.

Key strategic changes in 2011 included:

- A refreshed Coutts brand bringing Coutts UK and RBS Coutts under one single contemporary brand.
- A refocus on territories where the businesses have the opportunity for greatest scale or growth such as UK, Asia, Middle East, and Eastern Europe.
- Further development of client propositions as well as the portfolio of products and services for key international markets.
- Strategic investment in technology leading to the development of a single global technology platform for the Wealth division. The platform was successfully deployed in Adam & Company in 2011 with Coutts UK to follow in 2012.
- Strengthening the connectivity between Wealth and other Group divisions including referrals in international jurisdictions and improved connectivity with UK Corporate.
- Continued activity to ensure the division responds to new or expected regulatory changes with proactive solution design and preparation.
- Injection of new management into key roles from both internal and external sources including key segment heads, marketing, products & services, and international executive leadership.

Following the establishment of a single global brand in Q4 2011, focus turned to the reorganisation of key global functions such as marketing and product & services, as well as some local management structures. These reorganisations have realigned the division to maximise execution of the divisional strategy. The execution plan for the strategy will continue into 2012 and position Wealth strongly against its peers.

2011 compared with 2010
Operating profit decreased by 12% on 2010 to £248 million, driven by increases in expenses (13%) and impairments (39%) partially offset by a 7% growth in income.

Income increased by £69 million with a 24 basis points improvement in lending margins, strong treasury income and increases in lending and deposit volumes. Non-interest income rose 3%, with investment income growing 2% despite turbulent market conditions.

Expenses increased by £97 million, largely driven by adverse foreign exchange movements and headcount growth to service the increased revenue base. Additional strategic investment in technology enhancement, rebranding and programmes to support regulatory change also contributed to the increase.

Client assets and liabilities managed by the division decreased by 1%. Customer deposits grew 3% in a competitive environment and lending volumes grew 5%. Assets under management declined 9%, with fund outflows contributing 3% of the decrease and market conditions making up the balance.

2010 compared with 2009

2010 operating profit fell by 24% driven by lower net interest income and higher expenses, partly offset by a 45% decline in impairments in the year.

Income declined by 3% primarily due to lower net interest income. Strong lending and investment income was offset by the impact of a competitive deposit market.

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

Assets under management grew by 4% largely through improving market conditions.

Business review continued

International Banking

	2011	2010	2009
	£m	£m	£m
Net interest income from banking activities	1,199	1,353	1,665
Funding costs of rental assets	(42)	(37)	(49)
Net-interest income	1,157	1,316	1,616
Non-interest income	1,398	1,961	1,940
Total income	2,555	3,277	3,556
Direct expenses			
- staff	(706)	(871)	(934)
- other	(226)	(274)	(317)
Indirect expenses	(700)	(735)	(769)
	(1,632)	(1,880)	(2,020)
Profit before impairment losses	923	1,397	1,536
Impairment losses	(168)	(86)	(418)
Operating profit	755	1,311	1,118
Of which:			
Ongoing businesses	773	1,348	1,136
Run-off businesses	(18)	(37)	(18)
Analysis of income by product			
Cash management	940	1,368	1,298
Trade finance	275	243	246
Portfolio	1,265	1,578	1,886
Ongoing businesses	2,480	3,189	3,430
Run-off businesses	75	88	126
Total income	2,555	3,277	3,556
Analysis of impairments by sector			
Manufacturing and infrastructure	254	(17)	89
Property and construction	17	102	50
Transport and storage	11	—	2
Telecommunications, media and technology	—	7	—
Banks and other financial institutions	(42)	49	174
Other	(72)	(55)	103
	168	86	418
Performance ratios (ongoing businesses)			
Return on equity (1)	11.5%	15.4%	11.5%
Net interest margin	1.73%	1.92%	1.86%
Cost:income ratio	62%	55%	55%
	£bn	£bn	£bn
Capital and balance sheet			
Total third party assets (excluding derivatives mark-to-market)	69.9	77.9	75.3
Loans and advances	60.3	66.0	66.9

Customer deposits (excluding repos)	45.1	43.7	38.1
Risk elements in lending	1.6	1.5	1.0
Loan:deposit ratio (excluding repos)	126%	142%	171%
Risk-weighted assets	43.2	51.7	67.7
	£m	£m	£m
Run-off businesses (2)			
Total income	75	88	126
Direct expenses	(93)	(125)	(144)
Operating loss	(18)	(37)	(18)

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

(2) Run-off businesses consist of the exited corporate finance businesses.

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International Banking serves companies with a leading client proposition focused on financing, transaction services and risk management. The International Banking structure and governance were complete by the end of June 2012. Management is focused on leveraging the International network and the Transaction Services offering to ensure relevance and intimacy with the division's client base.

During the year, International Banking invested in improving existing products and services and also in developing new ones. To help corporate treasurers manage their global positions, the division launched a global Liquidity Solutions Portal, giving its customers a view of their operational and investment balances and rates all in one place, improving transparency, and enabling them to execute and redeem investments effectively.

2011 compared with 2010
Operating profit was down 42%, partly reflecting the sale of Global Merchant Services (GMS) which completed on 30 November 2010. Adjusting for the disposal, operating profit decreased 32%, driven by an impairment provision on a single name in 2011.

Excluding GMS income of £451 million, income was 10% lower despite the success of deposit-gathering initiatives, as deposits increased £2 billion in a competitive environment.

Excluding GMS expenses of £244 million, expenses decreased by £4 million, reflecting business improvement initiatives and investment in technology and support infrastructure.

Impairment losses increased to £168 million compared with £86 million in 2010 reflecting a single name impairment.

For the eleven months in 2010 before completion of the disposal, GMS generated income of £451 million, total expenses of £244 million and an operating profit of £207 million.

2010 compared with 2009
Operating profit increased 17%, driven by lower costs and impairment losses (which has more than compensated for the loss of Global Merchant Services (GMS) income). Adjusting for the disposal operating profit increased 28%.

For the eleven months before disposal, International Banking booked income of £451 million (2009 - £505 million) and total expenses of £244 million (2009 - £249 million) for GMS, generating an operating profit of £207 million (2009 - 256 million).

Income was down 8%, or 7% excluding GMS, reflecting lower deposit volumes in Cash Management business, a decline in the Trade Finance business.

Expenses decreased 7% to £1,880 million, as increased investment in front office and support infrastructure was offset by tight management of business costs.

Third party assets increased by £2.6 billion, or £1.5 billion excluding GMS, as Yen clearing activities were brought in-house and loans and advances increased.

Business review continued

Ulster Bank

	2011	2010	2009
	£m	£m	£m
Net interest income	736	839	763
Net fees and commissions	142	156	228
Other non-interest income	69	58	26
Non-interest income	211	214	254
Total income	947	1,053	1,017
Direct expenses			
- staff	(221)	(237)	(325)
- other	(67)	(74)	(86)
Indirect expenses	(259)	(264)	(342)
	(547)	(575)	(753)
Profit before impairment losses	400	478	264
Impairment losses	(1,384)	(1,161)	(649)
Operating loss	(984)	(683)	(385)
Analysis of income by business			
Corporate	435	521	580
Retail	428	465	412
Other	84	67	25
Total income	947	1,053	1,017
Analysis of impairments by sector			
Mortgages	570	294	74
Corporate			
- property	324	375	306
- other corporate	434	444	203
Other lending	56	48	66
Total impairment losses	1,384	1,161	649
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	2.8%	1.4%	0.5%
Corporate			
- property	6.8%	6.9%	3.0%
- other corporate	5.6%	4.9%	1.8%
Other lending	3.5%	3.7%	2.7%
Total	4.1%	3.1%	1.6%
Performance ratios			
Return on equity (1)	(22.8%)	(16.8%)	(12.7%)
Net interest margin	1.87%	2.03%	1.83%
Cost:income ratio	58%	55%	74%

Note:

(1) Divisional return on equity is based on divisional operating loss after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

	2011	2010	2009
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	20.0	21.2	16.2
- corporate			
- property	4.8	5.4	10.1
- other corporate	7.7	9.0	11.0
- other lending	1.6	1.3	2.4
	34.1	36.9	39.7
Customer deposits	21.8	23.1	21.9
Risk elements in lending			
- mortgages	2.2	1.5	0.6
- corporate			
- property	1.3	0.7	0.7
- other corporate	1.8	1.2	0.8
- other lending	0.2	0.2	0.2
Total risk elements in lending	5.5	3.6	2.3
Loan:deposit ratio (excluding repos)	143%	152%	177%
Risk-weighted assets	36.3	31.6	29.9
Spot exchange rate - €/£	1.196	1.160	1.126

2011 was another difficult year for the business due to the continued challenging economic environment. This was reflected in the financial performance, with ongoing pressure on income and a further increase in impairment losses.

Ulster Bank continues to make progress on its customer commitments and deposit gathering strategy, while cost management and targeting growth in areas that leverage competitive advantage, remain priorities. In 2011, customer numbers increased by 2%, representing a strong performance in current and savings accounts, driven by the enhanced customer service highlighted by our 'Help for what matters' programme.

Following a review of the cost base and operating model, 950 proposed job losses were announced in January 2012, the majority of which are expected by the end of 2012. This decision is a necessary part of the changes required to build a stronger sustainable business for the future.

2011 compared with 2010
Operating profit before impairment losses decreased by £78 million in 2011 with lower income partially mitigated by cost savings. Impairment losses of £1,384 million increased by 19% from 2010 resulting in an operating loss of £984 million, 44% higher than 2010.

Income fell by 10% driven by a contracting performing loan book coupled with higher funding costs. Loans and advances to customers decreased by 8% during 2011.

Expenses fell by 5% reflecting tight management of the cost base across the business.

Impairment losses increased by 19% largely reflecting the deterioration in credit metrics on the mortgage portfolio driven by a combination of higher debt flow and further fall in asset prices.

Despite intense competition, retail and small business deposit balances have grown strongly throughout 2011, driven by the benefits of a focused deposit gathering strategy. However, total customer deposit balances fell by 6% terms largely driven by the outflow of wholesale customer balances due to rating downgrades.

Risk-weighted assets increased by 15% in 2011 reflecting the deterioration in credit risk metrics.

Business review continued

Ulster Bank continued

2010 compared with 2009
Overall performance deteriorated in 2010, largely as a result of an increase in impairment losses of £512 million. Operating profit before impairment increased to £478 million, up 81%, driven by the culmination of a bank-wide cost saving programme during 2010.

Net interest income increased by 10%, as tightening deposit margins due to intensive market competition and movements in foreign exchange rates were offset by actions to increase asset margins.

Non-interest income was 16% lower, basis reflecting a non-recurring gain in 2009.

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

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

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

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

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

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

US Retail & Commercial

	2011 US$m	2010 US$m	2009 US$m	2011 £m	2010 £m	2009 £m
Net interest income	3,048	2,940	2,755	1,900	1,902	1,758
Net fees and commissions	1,350	1,328	1,335	841	859	853
Other non-interest income	473	464	368	296	301	235
Non-interest income	1,823	1,792	1,703	1,137	1,160	1,088
Total income	4,871	4,732	4,458	3,037	3,062	2,846
Direct expenses						
- staff	(1,344)	(1,238)	(1,239)	(838)	(801)	(792)
- other	(893)	(897)	(941)	(557)	(580)	(600)
Indirect expenses	(1,250)	(1,255)	(1,255)	(779)	(813)	(801)
	(3,487)	(3,390)	(3,435)	(2,174)	(2,194)	(2,193)
Profit before impairment losses	1,384	1,342	1,023	863	868	653
Impairment losses	(524)	(802)	(1,104)	(326)	(519)	(705)
Operating profit/(loss)	860	540	(81)	537	349	(52)
Average exchange rate - US$/£				1.604	1.546	1.566
Analysis of income by product						
Mortgages and home equity	744	786	781	463	509	499
Personal lending and cards	709	761	707	442	492	451
Retail deposits	1,487	1,465	1,518	927	948	969
Commercial lending	936	901	855	584	583	546
Commercial deposits	667	627	631	416	406	403
Other	328	192	(34)	205	124	(22)
Total income	4,871	4,732	4,458	3,037	3,062	2,846
Analysis of impairments by sector						
Residential mortgages	44	85	114	28	55	73
Home equity	165	164	261	103	106	167
Corporate and commercial	88	354	518	55	228	331
Other consumer	101	146	211	61	96	134
Securities	126	53	—	79	34	—
Total impairment losses	524	802	1,104	326	519	705
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Residential mortgages	0.5%	0.9%	1.1%	0.5%	0.9%	1.1%
Home equity	0.7%	0.7%	1.0%	0.7%	0.7%	1.1%
Corporate and commercial	0.2%	1.1%	1.6%	0.2%	1.1%	1.7%
Other consumer	0.8%	1.4%	1.7%	0.8%	1.4%	1.8%
Total	0.5%	1.0%	1.4%	0.5%	1.0%	1.4%
Performance ratios						
Return on equity (1)	6.3%	3.7%	(0.6%)	6.3%	3.7%	(0.6%)
Net interest margin	3.06%	2.82%	2.34%	3.06%	2.82%	2.34%

Cost:income ratio	72%	72%	77%	72%	72%	77%

Note:
(1) Divisional return on equity is based on divisional operating profit/(loss) after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

Business review continued

US Retail & Commercial continued

	2011 US$bn	2010 US$bn	2009 US$bn	2011 £bn	2010 £bn	2009 £bn
Capital and balance sheet						
Total third party assets	117.3	112.4	124.2	75.8	72.4	76.5
Loans and advances to customers (gross)						
- residential mortgages	9.4	9.4	10.6	6.1	6.1	6.5
- home equity	23.1	23.6	25.0	14.9	15.2	15.4
- corporate and commercial	35.3	31.7	31.6	22.9	20.5	19.5
- other consumer	12.0	10.7	12.2	7.7	6.9	7.5
	79.8	75.4	79.4	51.6	48.7	48.9
Customer deposits (excluding repos)	92.8	92.1	98.0	60.0	59.3	60.4
Risk elements in lending						
- retail	1.0	0.7	0.6	0.6	0.4	0.4
- commercial	0.6	0.7	0.4	0.4	0.5	0.2
Total risk elements in lending	1.6	1.4	1.0	1.0	0.9	0.6
Loan:deposit ratio (excluding repos)	85%	81%	80%	85%	81%	80%
Risk-weighted assets	91.8	89.1	97.5	59.3	57.4	60.1
Spot exchange rate - US$/£				1.548	1.552	1.622

Sterling weakened relative to the US dollar during the fourth quarter, with the average exchange rate decreasing by 2% compared with Q3 2011.

US R&C continued to focus on its back-to-basics strategy, with good progress made in developing the division's customer franchise during 2011. The bank continued to re-energise the franchise through new branding, product development and competitive pricing.

To strengthen retail alignment and improve efficiencies, US R&C formed a consolidated Consumer Banking division by combining management of the retail banking franchise with the consumer lending division during H2 2011. This continued focus on alignment is expected to further contribute to the improved penetration of loan products to deposit households, which has already increased in ten consecutive quarters. The penetration of on-line banking customers, a key indicator of customer retention, also continued to improve during 2011.

To enhance the customer experience, in Q4 2011, Consumer Banking introduced four core Customer Commitments, built around feedback received from customers in Massachusetts. In Q1 2012, the Commitments will be rolled out to Citizens Financial Group's (CFG's) entire branch footprint.

Significant organisational changes and investment in Commercial Banking, including unification under the RBS Citizens brand, has been important in positioning the business for growth. The enhanced sales training programme for managers and sales colleagues in this business has begun to deliver results with both higher credit balances and increased client satisfaction. External researchers TNS awarded Citizens the second highest score in relationship manager satisfaction among its competitors for 2011.

Risk management was also an important focus for 2011 and in Q4 2011, CFG's Board of directors approved a new formal risk appetite statement aimed at ensuring sustained predictable earnings and further strengthening the control environment.

2011 compared with 2010
Operating profit increased to £537 million ($860 million) from £349 million ($540 million), an increase of £188 million ($320 million), or 54%. Excluding a credit of £73 million ($113 million) related to changes to the defined benefit plan in Q2 2010, operating profit increased by £261 million ($433 million), or 95%, substantially driven by lower impairments and improved income.

The macroeconomic operating environment remained challenging, with low rates, high unemployment, a soft housing market, sluggish consumer activity and the continuing impact of legislative changes including the Durbin Amendment in the Dodd-Frank Act which became effective on 1 October 2011.

The Durbin Amendment lowers the allowable interchange on debit transactions to $0.23-$0.24 per transaction. The current annualised impact of the Durbin Amendment is estimated at £94 million ($150 million).

Net interest income was down £2 million. In US dollar terms, net interest income increased by $108 million, 4%. Net interest margin improved by 24 basis points to 3.06% reflecting changes in deposit mix, continued discipline around deposit pricing and the positive impact from the balance sheet restructuring programme carried out during Q3 2010 combined with strong commercial loan growth, partially offset by run-off of consumer loans.

Non-interest income was down £23 million, 2%. In US dollar terms, non-interest income increased by $31 million, 2%. The increase is primarily driven by higher account and transaction fees, partially offset by the impact of legislative changes on debit card and deposit fees.

Excluding the defined benefit plan credit of £73 million ($113 million) in Q2 2010, total expenses were down £93 million, 4% ($16 million in US dollar terms) due to a number of factors including lower Federal Deposit Insurance Corporation (FDIC) deposit insurance levies, and lower litigation and marketing costs, partially offset by higher regulatory costs.

Impairment losses declined by £193 million ($278 million), or 37%, largely reflecting an improved credit environment slightly offset by higher impairments related to securities. Loan impairments as a percent of loans and advances improved to 0.5% from 1.0%.

Customer deposits were up 1% with particularly strong growth achieved in checking balances. Consumer checking balances grew by 6%, while small business checking balances grew by 5% over the year.

2010 compared with 2009
Operating profit of £349 million ($540 million) represented a marked improvement from an operating loss of £52 million ($81 million) with income up 8% and impairment losses down 26%.

Net interest income was up 8%, despite a smaller balance sheet, with net interest margin improving by 48 basis points to 2.82%.

Non-interest income was up 7% reflecting higher mortgage banking and debit card income, commercial banking fees and higher gains on securities realisations. This was partially offset by lower deposit fees which were impacted by Regulation E legislative changes in 2010. In addition, gains of £213 million ($330 million) were recognised on the sale of available-for-sale securities as part of the balance sheet restructuring exercise, but these were almost wholly offset by losses crystallised on the termination of swaps hedging fixed-rate funding.

Total expenses were up £1 million ($45 million), reflecting a £73 million ($113 million) credit related to changes to the defined benefit pension plan, and lower Federal Deposit Insurance Corporation (FDIC) deposit insurance levies, partially offset by the impact of changing rates on the valuation of mortgage servicing rights and litigation costs.

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

Business review continued

Markets

	2011	2010	2009
	£m	£m	£m
Net interest income	67	581	1,095
Net fees and commissions receivable	371	520	347
Income from trading activities	4,601	5,234	7,669
Other operating income	(624)	(102)	(321)
Non-interest income	4,348	5,652	7,695
Total income	4,415	6,233	8,790
Direct expenses			
- staff	(1,963)	(2,082)	(2,197)
- other	(746)	(663)	(560)
Indirect expenses	(769)	(699)	(792)
	(3,478)	(3,444)	(3,549)
Profit before impairment losses	937	2,789	5,241
Impairment losses	(38)	(65)	(250)
Operating profit	899	2,724	4,991
Of which:			
Ongoing businesses	943	2,743	4,764
Run-off businesses	(44)	(19)	227
Analysis of income by product			
Rates	1,474	2,312	4,111
Currencies	1,060	1,047	1,220
Asset backed products (ABP)	1,254	1,479	1,534
Credit markets	616	1,350	1,612
Investor products and equity derivatives	593	672	862
Total income continuing businesses	4,997	6,860	9,339
Inter-divisional revenue share	(767)	(883)	(987)
Run-off businesses	185	256	438
Total income	4,415	6,233	8,790
Memo - Fixed income and currencies			
Rates/currencies/ABP/credit markets	4,402	6,191	8,477
Less primary credit markets	(688)	(863)	(1,069)
Total fixed income and currencies	3,714	5,328	7,408
Performance ratios (ongoing businesses)			
Return on equity (1)	6.1%	19.1%	44.1%
Cost:income ratio	79%	55%	40%
Compensation ratio (2)	44%	33%	25%

Notes:

(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

(2) Compensation ratio is based on staff costs as a percentage of total income.

	2011	2010	2009
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances	61.2	68.6	73.1
Reverse repos	100.4	94.7	73.3
Securities	108.1	115.8	102.1
Cash and eligible bills	28.1	38.8	74.0
Other	14.8	20.1	27.5
Total third party assets (excluding derivatives mark-to-market)	312.6	338.0	350.0
Net derivative assets (after netting)	37.0	37.4	68.0
Risk-weighted assets	120.3	110.3	72.4
Run-off businesses (£m)			
Total income	185	256	438
Direct expenses	(229)	(275)	(211)
Operating (loss)/profit	(44)	(19)	(227)
Balance sheet - run-off businesses (£bn)			
Total third party assets (excluding derivatives mark-to-market)	1.3	2.4	2.3

During Q4 2011, the market environment continued to weaken. Market volatility remained elevated and liquidity depressed as markets reacted to developments in the European sovereign debt crisis. Deal flow was weak reflecting investor pessimism about the outlook for the world economy. Throughout the year, Markets continued to deliver core products and innovative solutions to clients, while also focusing on management of its cost base and on tight control of its risk positions.

On 12 January 2012 the Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes saw the reorganisation of RBS's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities. The changes will ensure the wholesale businesses continue to deliver against the Group's strategy.

2011 compared with 2010
Operating profit fell by 67%, from £2,724 million for 2010 to £899 million for 2011, driven by a 29% decrease in revenue. The year was characterised by volatile and deteriorating credit markets, especially during the second half of the year when the European sovereign debt crisis drove a sharp widening in credit spreads.

Due to this deterioration in the markets both the Rates and Credit businesses suffered significantly, and income from trading activities, which is after funding costs both internal and external, fell from £5,234 million in 2010, to £4,601 million in 2011. The heightened volatility increased risk aversion amongst clients and limited opportunities for revenue generation in the secondary markets.

Total costs increased by 1% due increased investment costs in 2011, which included a programme to meet new regulatory requirements. The compensation ratio in Markets was 44%, driven by fixed salary costs and prior year deferred awards.

Variable compensation accrued in the first half of the year were reduced in the second half of the year, leaving the former GBM 2011 variable compensation awards 58% lower than 2010.

Third party assets fell from £338.0 billion in 2010 to £312.6 billion in 2011 as a result of lower levels of activity and careful management of balance sheet exposures.

A 9% increase in risk-weighted assets reflected the impact of significant regulatory changes, with a £21 billion uplift as a result of CRD III, largely offset by the impact of the division's focus on risk management.

2010 compared with 2009
A fall in operating profit, of 45% year on year reflects sharply reduced revenue partially offset by lower costs and a significant improvement in impairments.

Total income was £2,557 million lower in 2010 driven by increased risk aversion in the market during Q3 and Q4 2010, combined with the non-repeat of favourable market conditions seen in the first half of 2009.

- Higher revenue across the Rates and Currencies businesses during 2009 was driven by rapidly falling interest rates and wide bid-offer spreads generating exceptional revenue opportunities, which have not been repeated in 2010.
- The Credit Markets business weakened by 16%, reflecting lower levels of activity in debt capital markets.

Expenses fell by 3% to £3,444 million. This was largely driven by a decrease in staff costs, including on-going benefits from cost synergies.

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

Business review continued

Direct Line Group

	2011	2010	2009
	£m	£m	£m
Earned premiums	4,221	4,459	4,519
Reinsurers' share	(252)	(148)	(165)
Net premium income	3,969	4,311	4,354
Fees and commissions	(400)	(410)	(367)
Instalment income	138	159	171
Investment income	265	277	305
Other income	100	179	151
Total income	4,072	4,516	4,614
Direct expenses			
- staff expenses	(288)	(287)	(304)
- other expenses	(333)	(325)	(368)
Indirect expenses	(225)	(267)	(270)
	(846)	(879)	(942)
Impairment losses	-	-	(8)
Net claims	(2,772)	(3,932)	(3,606)
Operating profit/(loss)	454	(295)	58
Analysis of income by product			
Personal lines motor excluding broker			
- own brands	1,874	1,962	1,814
- partnerships	228	373	360
Personal lines home excluding broker			
- own brands	490	488	442
- partnerships	378	408	389
Personal lines rescue and other excluding broker			
- own brands	185	197	191
- partnerships	132	168	220
Commercial	365	341	305
International	346	333	288
Other (1)	74	246	605
Total income	4,072	4,516	4,614
In-force policies (000s)			
Personal lines motor excluding broker			
- own brands	3,787	4,162	4,762
- partnerships	320	645	844
Personal lines home excluding broker			
- own brands	1,811	1,797	1,774
- partnerships	2,497	2,530	2,566
Personal lines rescue and other excluding broker			
- own brands	1,844	1,966	2,262
- partnerships	7,307	7,497	6,688
Commercial	422	352	346
International	1,387	1,082	944

Other (1)	1	644	1,049
Total in-force policies (2)	19,376	20,675	21,235

For notes relating to this table refer to page 44.

	2011	2010	2009
	£m	£m	£m
Gross written premium			
Personal lines motor excluding broker			
- own brand	1,584	1,647	1,738
- partnerships	137	257	311
Personal lines home excluding broker			
- own brand	474	478	462
- partnerships	549	556	560
Personal lines rescue and other excluding broker			
- own brand	174	178	176
- partnerships	174	159	141
Commercial	435	397	395
International	570	425	354
Other (1)	1	201	343
Total gross written premium	4,098	4,298	4,480
Performance ratios			
Return on regulatory capital (3)	11.3%	(7.9%)	1.7%
Return on tangible equity (4)	10.3%	(6.8%)	1.4%
Loss ratio (5)	70%	91%	83%
Commission ratio (6)	10%	10%	8%
Expense ratio (7)	20%	20%	21%
Combined operating ratio (8)	100%	121%	112%
Balance sheet			
Total insurance reserves (£m) (9)	7,284	7,643	7,139

Notes:
(1) 'Other' predominately consists of the personal lines broker business.
(2) Total in-force policies include travel and creditor policies sold through RBS Group. These comprise travel policies included in bank accounts e.g. Royalties Gold Account, and creditor policies sold with bank products including mortgage, loan and card payment protection.
(3) Return on regulatory capital required is based on annualised operating profit/(loss) after tax divided by average notional regulatory equity.
(4) Return on tangible equity is based on annualised operating profit/(loss) after tax divided by average tangible equity.
(5) Loss ratio is based on net claims divided by net premium income.
(6) Commission ratio is based on fees and commissions divided by gross written premium income.
(7) Expense ratio is based on expenses divided by gross written premium.
(8) Combined operating ratio is the sum of the loss, commission and expense ratios.
(9) Consists of general and life insurance liabilities, unearned premium reserves and liability adequacy reserve.

Direct Line Group continued
Direct Line Group continues to make good progress ahead of its divestment from the Group. Operating profit of £454 million for 2011 shows a return to full year profitability and represents close to a £750 million turnaround from 2010. These results demonstrate the success of the first phase of management’s transformation plan - to return to profit in 2011. The full year combined operating ratio improved to 100% (2010 - 121%) with a full year return on equity of 10.3% compared with a negative return of 6.8% in 2010.

The second phase of the Direct Line Group transformation plan, to build competitive advantage, is underway and tangible benefits are already being delivered. All new Churchill, Direct Line and Privilege motor claims, as well as all new Churchill home claims, are now being processed through a new claims management system. Within motor, the rollout of a new rating engine and new pricing tools ensured more accurate and tailored pricing with the aim of generating greater value from Direct Line Group's multi-brand, multi-distribution strategy.

As part of the plan to build competitive advantage, the rationalisation of occupied sites continues, with 15 site exits by the end of 2011. The consolidation of the four UK general insurance underwriting entities within the Direct Line Group was successfully completed in December 2011. All UK general insurance business is now written through one underwriter with the aim of improving operational and capital efficiency.

Marking a significant new partnership, Direct Line Group signed a five-year contract with Sainsbury’s Finance in 2011 to provide underwriting, sales, service and claims management for its car insurance customers. Following the successful launch and development of the car insurance partnership, a further contract was signed early in 2012 to provide home insurance for Sainsbury’s customers. Building on Direct Line Group’s established successful relationship with Nationwide Building Society, a deal was concluded to extend its provision of home insurance until the end of 2015. Direct Line Group is also concluding terms with RBS Group’s UK Retail bank on the details of a five-year agreement for the continued provision of general insurance products post separation. The term would commence from the point of initial divestment.

While overall gross written premium fell by 5% in 2011, it increased by 10% in Commercial, which includes NIG, the commercial broker business, and Direct Line for Business, the direct SME insurer. A new brand identity was unveiled for NIG and work continued to improve its product offering and service to brokers. Direct Line for Business continued to develop well.

Direct Line Group’s international division showed strong growth in gross written premiums primarily in Italy, assisted by the first full year of its sales agreements with FGA Capital, a joint venture between Fiat and Credit Agricole. The German business also showed good growth following improvements in the second half of 2011 to its direct and partnership business, including strengthening its relationship with Renault.

Ahead of the planned divestment in the second half of 2012, Direct Line Group has begun separating its activities and operations from RBS Group. Its corporate functions have been strengthened, arm’s length agreements are under discussion with the Group where appropriate, a new corporate brand, Direct Line Group was announced on 15 February 2012 and a new risk and control framework has been implemented, in readiness for standalone status.

Overall, Direct Line Group has powerful brands, improved earnings, a robust balance sheet and is executing the second phase of its transformation plan to rebuild competitive advantage.

2011 compared with 2010
Operating profit rose by £749 million in 2011, principally due to the non repeat of the bodily injury reserve strengthening in 2010, derisking of the motor book, exit of certain business segments and more benign weather in 2011.

Gross written premium fell £200 million, 5%, as the business continued to drive improved profitability through reduced volumes in unattractive segments. This was partially offset by growth in Commercial and International.

Total income fell £444 million, 10%, following the exit of personal lines broker, a decline in premiums reflecting reduced motor volumes and higher reinsurance costs to reduce the risk profile of the book. Investment income fell £12 million, 4%, reflecting decreased yields on the portfolio in 2011, partially offset by higher realised gains.

Total direct expenses rose by £9 million principally driven by project activity to support the transformation plan.

Net claims fell £1,160 million, 30%, due to the non recurrence of bodily injury reserve strengthening in 2010, actions taken to de-risk the book, the exit of certain business segments and more benign weather in 2011.

At the end of 2011, Direct Line Group 's investment portfolios comprised primarily cash, gilts and investment grade bonds. Within the UK portfolio, £8.9 billion, and the International portfolio, £827 million, there was no exposure to sovereign debt issued by Portugal, Ireland, Italy, Greece or Spain.

Total in-force policies fell 6% in the year due to planned de-risking of the motor book and the exiting of certain other segments and partnerships, including personal lines broker.

2010 compared with 2009
Direct Line Group has embarked on a significant programme of investment designed to achieve a substantial lift in operational and financial performance, ahead of the planned divestment of the business, with a current target date of 2012. This programme encompasses the enhancement of pricing capability, transformation of claims operations and expense reduction, together with a range
of other improvements across the business, including a greater focus on capital management.

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

Income was down 2% (£98 million) against 2009, driven by a managed reduction in the risk of the UK motor book, largely offset by significant price increases:

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

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

Initiatives to grow ancillary income were also implemented during the year resulting in revenues of £46 million in 2010 (£25 million in 2009). Away from UK motor, overall home gross written premiums grew by 1%. This included the exit from less profitable business in line with overall strategy. Our underlying own brands business continues to grow successfully, with gross written premiums increasing 4%.

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

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

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

Total income declined by £98 million, with lower motor premium income, driven by rating action. Increased fees and commissions reflected profit sharing arrangements with UK Retail in relation to insurance distribution to bank customers. Investment income was £28 million lower, reflecting the impact of low interest rates on returns on the investment portfolio as well as lower gains realised on the sale of investments.

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

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

Central items

	2011	2010	2009
	£m	£m	£m
Central items not allocated	191	630	456

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.

2011 compared with 2010
Central items not allocated represented a credit of £191 million in 2011, a decline of £439 million compared with 2010. 2010 benefited from c.£300 million of accounting gains on hybrid securities, c.£150 million of which was amortised during 2011. A VAT recovery of £176 million in 2010 compared with £85 million recovered in 2011.

2010 compared with 2009
Central items not allocated including available-for-sale (AFS) gains of £237 million and one-off VAT recovery in 2010 of £170 million, amounted to a net credit of £630 million, an increase of £174 million on 2009.

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

Non-Core

	2011	2010	2009
	£m	£m	£m
Net interest income	858	1,756	1,603
Funding costs of rental assets	(210)	(283)	(256)
Net interest income	648	1,473	1,347
Net fees and commissions	(38)	471	510
Loss from trading activities	(721)	(31)	(5,161)
Insurance net premium income	286	702	784
Other operating income			
- rental income	953	1,035	946
- other (1)	60	(896)	(700)
Non-interest income/(loss)	540	1,281	(3,621)
Total income/(loss)	1,188	2,754	(2,274)
Direct expenses			
- staff	(375)	(731)	(851)
- operating lease depreciation	(347)	(452)	(402)
- other	(256)	(573)	(573)
Indirect expenses	(317)	(500)	(552)
	(1,295)	(2,256)	(2,378)
Profit before insurance net claims and impairment losses	(107)	498	(4,652)
Insurance net claims	(195)	(737)	(588)
Impairment losses	(3,919)	(5,476)	(9,221)
Operating loss	(4,221)	(5,715)	(14,461)
Analysis of income/(loss) by business			
Banking and portfolios	1,465	1,463	(148)
International businesses	411	778	1,296
Markets	(688)	513	(3,422)
Total income/(loss)	1,188	2,754	(2,274)
Loss from trading activities			
Monoline exposures	(670)	(5)	(2,387)
Credit derivative product companies	(85)	(139)	(947)
Asset-backed products (2)	29	235	(288)
Other credit exotics	(175)	77	(558)
Equities	(11)	(17)	(47)
Banking book hedges	(1)	(82)	(1,613)
Other (3)	192	(100)	679
	(721)	(31)	(5,161)
Impairment losses			
Banking and portfolios	3,833	5,328	8,350
International businesses	82	200	499
Markets	4	(52)	372
Total impairment losses	3,919	5,476	9,221

Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) (4)			
Banking and portfolios	4.9%	5.0%	5.8%
International businesses	3.7%	4.4%	4.1%
Markets	(3.0%)	0.2%	7.5%
Total	4.8%	4.9%	5.7%

Notes:

(1) Includes losses on disposals of £127 million for 2011 (2010 - £504 million).

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

(3) Includes profits in RBS Sempra Commodities JV of £4 million for 2011 (2010 - £372 million).

(4) Includes disposal groups.

Business review continued

Non-Core continued

	2011	2010	2009
Performance ratios			
Net interest margin	0.63%	1.02%	0.74%
Cost:income ratio	109%	82%	(105%)
Adjusted cost:income ratio	130%	112%	(83%)
	£bn	£bn	£bn
Capital and balance sheet			
Total third party assets (excluding derivatives) (1)	93.7	137.9	201.0
Total third party assets (including derivatives) (1)	104.7	153.9	220.9
Loans and advances to customers (gross) (2)	79.4	108.4	149.5
Customer deposits (2)	3.5	6.7	12.6
Risk elements in lending (2)	24.0	23.4	22.9
Risk-weighted assets (1)	93.3	153.7	171.3
Gross customer loans and advances			
Banking and portfolios	77.3	104.9	138.3
International businesses	2.0	3.5	9.4
Markets	0.1	-	1.8
	79.4	108.4	149.5
Risk-weighted assets			
Banking and portfolios	64.8	83.5	92.5
International businesses	4.1	5.6	11.5
Markets	24.4	64.6	67.3
	93.3	153.7	171.3
Third party assets (excluding derivatives)			
Banking and portfolios	81.3	113.9	153.2
International businesses	2.9	4.4	10.9
Markets	9.5	19.6	36.9
	93.7	137.9	201.0

Third party assets (excluding derivatives)	31 December 2010 £bn	Run-off £bn	Disposals/ restructuring £bn	Drawings/ roll overs £bn	Impairments £bn	FX £bn	31 December 2011 £bn
Commercial real estate	42.6	(5.6)	(2.4)	0.7	(3.4)	(0.4)	31.5
Corporate	59.8	(8.5)	(11.3)	2.5	(0.1)	(0.2)	42.2
SME	3.7	(1.6)	-	0.1	(0.1)	-	2.1
Retail	9.0	(1.1)	(1.4)	-	(0.3)	(0.1)	6.1
Other	2.5	(0.6)	-	-	-	-	1.9
Markets	13.6	(2.9)	(1.8)	1.0	-	(0.1)	9.8
Total (excluding derivatives)	131.2	(20.3)	(16.9)	4.3	(3.9)	(0.8)	93.6
	6.7	(1.3)	(5.0)	-	-	(0.3)	0.1

Markets - RBS Sempra Commodities JV							
Total (3)	137.9	(21.6)	(21.9)	4.3	(3.9)	(1.1)	93.7

Notes:
(1) Includes RBS Sempra Commodities JV (2011 third party assets, excluding derivatives (TPAs) £0.1 billion, RWAs £1.6 billion; 2010 TPAs £6.7 billion, RWAs £4.3 billion).
(2) Excluding disposal groups.
(3) Disposals of £0.2 billion have been signed as at 31 December 2011 (2010 - £12 billion).

Impairment losses by donating division and sector	2011 £m	2010 £m	2009 £m
UK Retail			
Mortgages	5	5	6
Personal	(27)	8	47
Total UK Retail	(22)	13	53
UK Corporate			
Manufacturing and infrastructure	76	26	87
Property and construction	224	437	651
Transport	52	3	10
Financial institutions	5	69	102
Lombard	75	129	95
Other	96	166	732
Total UK Corporate	528	830	1,677
Ulster Bank			
Mortgages	-	42	42
Commercial real estate			
- investment	609	630	286
- development	1,552	1,759	733
Other corporate	173	251	217
Other EMEA	15	52	106
Total Ulster Bank	2,349	2,734	1,384
US Retail & Commercial			
Auto and consumer	58	82	136
Cards	(9)	23	130
SBO/home equity	201	277	452
Residential mortgages	16	4	54
Commercial real estate	40	185	224
Commercial and other	(3)	17	83
Total US Retail & Commercial	303	588	1,079
International Banking			
Manufacturing and infrastructure	57	(290)	1,404
Property and construction	752	1,296	1,413
Transport	(3)	33	178
Telecoms, media and technology	68	9	545
Financial institutions	(98)	196	620
Other	(19)	14	616
Total International Banking	757	1,258	4,776
Other			
Wealth	1	51	251
Central items	3	2	1
Total Other	4	53	252
Total impairment losses	3,919	5,476	9,221

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Business review continued

Non-Core continued

Gross loans and advances to customers (excluding reverse repurchase agreements) by donating division and sector	2011 £bn	2010 £bn	2009 £bn
UK Retail			
Mortgages	1.4	1.6	1.9
Personal	0.1	0.4	0.7
Total UK Retail	1.5	2.0	2.6
UK Corporate			
Manufacturing and infrastructure	0.1	0.3	0.3
Property and construction	5.9	11.4	14.1
Transport	4.5	5.4	—
Financial institutions	0.6	0.8	—
Lombard	1.0	1.7	2.9
Other	7.5	7.4	17.6
Total UK Corporate	19.6	27.0	34.9
Ulster Bank			
Mortgages	—	—	6.0
Commercial real estate			
- investment	3.9	4.0	2.1
- development	8.5	8.4	6.3
Other corporate	1.6	2.2	1.3
Other EMEA	0.4	0.4	1.0
Total Ulster Bank	14.4	15.0	16.7
US Retail & Commercial			
Auto and consumer	0.8	2.6	3.2
Cards	0.1	0.1	0.5
SBO/home equity	2.5	3.2	3.7
Residential mortgages	0.6	0.7	0.8
Commercial real estate	1.0	1.5	1.9
Commercial and other	0.4	0.5	0.9
Total US Retail & Commercial	5.4	8.6	11.0
International Banking			
Manufacturing and infrastructure	6.6	8.7	17.5
Property and construction	15.3	19.6	25.7
Transport	3.2	5.5	5.8
Telecoms, media and technology	0.7	0.9	3.2
Financial institutions	5.6	12.0	16.0
Other	7.0	9.3	14.3
Total International Banking	38.4	56.0	82.5
Other			
Wealth	0.2	0.4	2.6
Direct Line Group	-	0.2	0.2

Central items	(0.2)	(1.0)	(3.2)
Total Other	-	(0.4)	(0.4)
Gross loans and advances to customers (excluding reverse repurchase agreements)	79.3	108.2	147.3

Non-Core third party assets fell to £94 billion, below the revised year end target of £96 billion and significantly ahead of the original guidance of £118 billion. Further reductions will include the sale of RBS Aviation Capital for £4.7 billion, which was signed in January 2012. Since the division was formed in 2009, the reduction totals £164 billion, or 64%. By the end of 2011, the Non-Core funded balance sheet equated to less than 10% of the Group funded balance sheet compared with 21% when the division was created.

The division focused on reducing capital intensive trading assets, with activity including the restructuring of monoline exposures, which, at a cost of c.£600 million in 2011, achieved a reduction of £60 billion in risk-weighted assets.

An operating loss of £4,221 million for 2011 was £1,494 million lower than 2010. Income declined by £1,566 million reflecting continued divestment, including business and country exits. The decrease was partially offset by a reduction in expenses of £961 million, largely driven by the fall in headcount. Impairment losses fell by £1,557 million despite ongoing challenges in the real estate and Ulster Bank portfolios.

2011 compared with 2010
Operating loss of £4,221 million in 2011 was £1,494 million lower than the loss recorded in 2010. The continued divestment of Non-Core businesses and portfolios has reduced revenue streams as well as the cost base.

Losses from trading activities increased by £704 million compared with 2010, principally as a result of the disposal of RBS Sempra Commodities in 2010 and costs incurred as part of the division's focus on reducing capital intensive trading assets and mitigating future regulatory uplifts in risk-weighted assets.

Impairment losses fell by £1,557 million despite ongoing challenges in the real estate and Ulster Bank portfolios, reflecting improvements in other asset classes.

Third party assets declined by £44 billion (32%) reflecting disposals of £22 billion and run-off of £22 billion.

Risk-weighted assets were £60 billion lower than 2010, principally driven by significant disposal activity on trading book assets combined with run-off.

Headcount declined by 2,189 (32%) to 4,669 in 2011, largely reflecting the divestment activity in relation to Asia, Non-Core Insurance and RBS Sempra Commodities.

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

2010 operating losses in Non-Core were 60% lower than those recorded in 2009. The improvement in performance was driven by significantly lower trading losses, reduced expenses and a marked decline in impairments.

Losses from trading activities declined from £5,122 million for 2009 to £16 million for 2010 as underlying asset prices recovered, offset by continuing weakness in credit spreads. The division has recorded profits on the disposal of many asset-backed securities positions. In addition, a significantly smaller loss of £82 million was recorded on banking book hedges as spreads tightened, compared with £1,727 million in 2009.

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

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

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

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

Consolidated balance sheet at 31 December 2011

	2011 £m	2010 £m	2009 £m
Assets			
Cash and balances at central banks	79,269	57,014	52,261
Net loans and advances to banks	43,870	57,911	56,656
Reverse repurchase agreements and stock borrowing	39,440	42,607	35,097
Loans and advances to banks	83,310	100,518	91,753
Net loans and advances to customers	454,112	502,748	687,353
Reverse repurchase agreements and stock borrowing	61,494	52,512	41,040
Loans and advances to customers	515,606	555,260	728,393
Debt securities	209,080	217,480	267,254
Equity shares	15,183	22,198	19,528
Settlement balances	7,771	11,605	12,033
Derivatives	529,618	427,077	441,454
Intangible assets	14,858	14,448	17,847
Property, plant and equipment	11,868	16,543	19,397
Deferred tax	3,878	6,373	7,039
Prepayments, accrued income and other assets	10,976	12,576	20,985
Assets of disposal groups	25,450	12,484	18,542
Total assets	1,506,867	1,453,576	1,696,486
Liabilities			
Bank deposits	69,113	66,051	104,138
Repurchase agreements and stock lending	39,691	32,739	38,006
Deposits by banks	108,804	98,790	142,144
Customers deposits	414,143	428,599	545,849
Repurchase agreements and stock lending	88,812	82,094	68,353
Customer accounts	502,955	510,693	614,202
Debt securities in issue	162,621	218,372	267,568
Settlement balances	7,477	10,991	10,413
Short positions	41,039	43,118	40,463
Derivatives	523,983	423,967	424,141
Accruals, deferred income and other liabilities	23,125	23,089	30,327
Retirement benefit liabilities	2,239	2,288	2,963
Deferred tax	1,945	2,142	2,811
Insurance liabilities	6,312	6,794	10,281
Subordinated liabilities	26,319	27,053	37,652
Liabilities of disposal groups	23,995	9,428	18,890
Total liabilities	1,430,814	1,376,725	1,601,855
Non-controlling interests	1,234	1,719	16,895
Owners’ equity	74,819	75,132	77,736
Total equity	76,053	76,851	94,631
Total liabilities and equity	1,506,867	1,453,576	1,696,486

Commentary on consolidated balance sheet
2011 compared with 2010
Total assets of £1,506.9 billion at 31 December 2011 were up £53.3 billion, 4%, compared with 31 December 2010. This principally reflects an increase in cash and balances at central banks and the mark-to-market value of derivatives in Markets, partly offset by decreases in debt securities and equity shares and the continuing disposal and run-off of Non-Core assets.

Cash and balances at central banks were up £22.3 billion, 39%, to £79.3 billion due to improvements in the Group's structured liquidity position during 2011.

Loans and advances to banks decreased by £17.2 billion, 17%, to £83.3 billion. Reverse repurchase agreements and stock borrowing ('reverse repos') were down £3.2 billion, 7%, to £39.4 billion and bank placings declined £14.0 billion, 24%, to £43.9 billion, primarily as a result of the reduction in exposure to eurozone banks and lower cash collateral requirements.

Loans and advances to customers were down £39.7 billion, 7%, to £515.6 billion. Within this, reverse repurchase agreements were up £9.0 billion, 17%, to £61.5 billion. Customer lending decreased by £48.7 billion, 10%, to £454.1 billion or £46.9 billion, 9%, to £473.9 billion before impairment provisions. This reflected the transfer to disposal groups of £19.5 billion of customer balances relating to the UK branch-based businesses. There were also planned reductions in Non-Core of £28.1 billion, together with declines in International Banking, £4.7 billion, UK Corporate, £3.0 billion and Ulster Bank, £2.0 billion, together with the effect of exchange rate and other movements, £1.9 billion. These were partially offset by growth in Markets, £6.4 billion, Wealth, £0.8 billion, UK Retail, £2.3 billion and US Retail & Commercial, £2.8 billion.

Debt securities were down £8.4 billion, 4%, to £209.1 billion driven mainly by a reduction in holdings of government and financial institution bonds in Markets and Group Treasury.

Equity shares decreased £7.0 billion, 32%, to £15.2 billion which largely reflects the closure of positions to reduce the Group's level of unsecured funding requirements to mitigate the potential impact of unfavourable market conditions.

Settlement balances declined £3.8 billion, 33% to £7.8 billion as a result of decreased customer activity.

Movements in the value of derivative assets up £102.5 billion, 24%, to £529.6 billion, and liabilities, up £100.0 billion, 24%, to £524.0 billion, primarily reflect increases in interest rate contracts as a result of a significant downward shift in interest rates across all major currencies, together with increases in the mark-to-market value of credit derivatives as a result of widening credit spreads and rising credit default swap prices.

Property, plant and equipment declined £4.7 billion, 28%, to £11.9 billion, primarily as a result of the transfer of RBS Aviation Capital's operating lease assets to disposal groups.

Deferred taxation was down £2.5 billion, 39%, to £3.9 billion, largely as a result of the utilisation of brought forward tax losses in the UK.

The increase in assets and liabilities of disposal groups reflects the reclassification of the UK branch-based businesses and RBS Aviation Capital pending their disposal, partly offset by the completion of disposals, primarily RBS Sempra Commodities JV and certain Non-Core project finance assets.

Deposits by banks increased £10.0 billion, 10%, to £108.8 billion, with higher repurchase agreements and stock lending ('repos'), up £6.9 billion, 21%, to £39.7 billion and higher inter-bank deposits, up £3.1 billion, 5%, to £69.1

billion.

Customer accounts fell £7.7 billion, 2%, to £503.0 billion. Within this, repos increased £6.7 billion, 8%, to £88.8 billion. Excluding repos, customer deposits were down £14.4 billion, 3%, to £414.1 billion, reflecting the transfer to disposal groups of £21.8 billion of customer accounts relating to the UK branch-based businesses. This was partly offset by the net effect of growth in International Banking £1.7 billion, UK Corporate, £1.8 billion, UK Retail, £5.8 billion, US Retail & Commercial, £0.5 billion and Wealth, £1.8 billion, together with exchange rate and other movements of £0.5 billion and declines in Markets, £1.1 billion, Ulster Bank, £0.8 billion and Non-Core, £2.9 billion.

Debt securities in issue were down £55.8billion, 26% to £162.6 billion driven by reductions in the level of certificates of deposit and commercial paper in Markets and Group Treasury.

Settlement balances declined £3.5 billion, 32%, to £7.5 billion and short positions were down £2.1 billion, 5%, to £41.0 billion due to decreased customer activity.

Subordinated liabilities were down £0.7 billion, 3%, to £26.3 billion, primarily reflecting the redemption of £0.2 billion US dollar and £0.4 billion Euro denominated dated loan capital.

The Group’s non-controlling interests decreased by £0.5 billion, 28%, to £1.2 billion, primarily due to the disposal of the majority of the RBS Sempra Commodities JV business, £0.4 billion.

Owners’ equity decreased by £0.3 billion to £74.8 billion. This was driven by the attributable loss for the year, £2.0 billion, together with the recognition of actuarial losses in respect of the Group’s defined benefit pension schemes, net of tax, £0.5 billion and exchange rate and other movements of £0.3 billion. Offsetting these reductions were gains in available-for-sale reserves, £1.1 billion and cashflow hedging reserves, £1.0 billion and the issue of shares under employee share schemes, £0.4 billion.

Business review continued

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

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

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

Loans and advances to customers decreased £173.1 billion, 24%, to £555.3 billion. Excluding the disposal of the RFS minority interest, lending to customers was down £40.4 billion, 7%. Within this, reverse repurchase agreements were up £11.5 billion, 28%, to £52.5 billion. Customer lending decreased by £51.9 billion to £502.7 billion or £48.9 billion before impairment provisions. This reflected planned reductions in Non-Core of £39.6 billion along with declines in Markets, £11.9 billion, International Banking, £3.6 billion, US Retail & Commercial, £2.6 billion and Ulster Bank, £1.9 billion. These were partially offset by growth in UK Retail, £5.4 billion, Wealth, £2.4 billion and UK Corporate, £0.8 billion, together with the effect of exchange rate and other movements, £2.1 billion.

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

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

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

Deposits by banks declined £43.4 billion, 31%, to £98.8 billion or £66.1 billion, 36% following the disposal of the RFS minority interest, with reduced inter-bank deposits, down £49.7 billion, 43%, to £66.1 billion and lower repurchase agreements and stock lending ('repos'), down £5.3 billion, 14%, to £32.7 billion.

Customer accounts decreased £103.5 billion, 17%, to £510.7 billion but excluding the disposal of the RFS minority interest were up £28.1 billion, 6%. Within this, repos increased £13.7 billion, 20%, to £82.1 billion. Excluding repos, customer deposits were up £14.3 billion, 3%, to £428.6 billion, reflecting growth in UK Corporate, £13.7 billion, International Banking, £5.4 billion, UK Retail, £7.0 billion, Ulster Bank, £1.7 billion and Wealth, £0.7 billion, together with exchange rate and other movements of £3.4 billion. This was partially offset by decreases in Markets, £7.8 billion, US Retail & Commercial, £3.8 billion and Non-Core, £6.0 billion.

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

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

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

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

Business review continued

Cash flow

	2011	2010	2009
	£m	£m	£m
Net cash flows from operating activities	3,325	19,291	(992)
Net cash flows from investing activities	14	3,351	54
Net cash flows from financing activities	(1,741)	(14,380)	18,791
Effects of exchange rate changes on cash and cash equivalents	(1,473)	82	(8,592)
Net increase in cash and cash equivalents	125	8,344	9,261

2011
The major factors contributing to the net cash inflow from operating activities of £3,325 million were the elimination of foreign exchange differences of £2,702 million, depreciation and amortisation of £1,875 million and inflow from other items of £2,900 million, partially offset by the net operating loss before tax of £708 million from continuing and discontinued operations and the decrease of £3,444 million in operating assets and liabilities.

Net cash inflows from investing activities of £14 million related to the net inflows from sales of securities of £3,074 million, and sale of property, plant and equipment of £1,840 million offset by net cash outflows from investments in business interests and intangible assets of £1,428 million and from the purchase of property, plant and equipment of £3,472 million.

Net cash outflows from financing activities of £1,741 million relate primarily to interest on subordinated liabilities of £714 million, repayment of subordinated liabilities of £627 million and redemption of non-controlling interests of £382 million.

2010
The major factors contributing to the net cash inflow from operating activities of £19,291 million were the increase of £17,095 million in operating assets less operating liabilities, depreciation and amortisation of £2,220 million and income taxes received of £565 million, partly offset by the net operating loss before tax of £940 million from continuing and discontinued operations.

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

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

2009
The major factors contributing to the net cash outflow from operating activities of £992 million were the net operating loss before tax of £2,696 million from continuing and discontinued operations, the decrease of £15,964 million in operating liabilities less operating assets, partly offset by the elimination of foreign exchange differences of £12,217 million and other items of £5,451 million.

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

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

Capital resources

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

	2011	2010	2009	2008	2007
	£m	£m	£m	£m	£m
Capital base					
Tier 1 capital	56,990	60,124	76,421	69,847	44,364
Tier 2 capital	8,546	9,897	15,389	32,223	33,693
Tier 3 capital	—	—	—	260	200
	65,536	70,021	91,810	102,330	78,257
Less: Supervisory deductions	(4,828)	(4,732)	(4,565)	(4,155)	(10,283)
Total regulatory capital	60,708	65,289	87,245	98,175	67,974
Risk-weighted assets (1)					
Credit risk	344,300	385,900	513,200	551,300	
Counterparty risk	61,900	68,100	56,500	61,100	
Market risk	64,000	80,000	65,000	46,500	
Operational risk	37,900	37,100	33,900	36,900	
	508,100	571,100	668,600	695,800	
Asset Protection Scheme relief	(69,100)	(105,600)	(127,600)	n/a	
	439,000	465,500	541,000	695,800	
Banking book:					
On-balance sheet					480,200
Off-balance sheet					84,600
Trading book					44,200
					609,000
Risk asset ratios	%	%	%	%	%
Core Tier 1	10.6	10.7	11.0	6.6	4.5
Tier 1	13.0	12.9	14.1	10.0	7.3
Total	13.8	14.0	16.1	14.1	11.2

Note:

(1) The data for 2008 onwards are on a Basel II basis; 2007 is on a Basel I basis.

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the Financial Services Authority (FSA). The FSA uses Risk Asset Ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. At 31 December 2011, the Group's total RAR was 13.8% (2010 - 14.0%) and the Tier 1 RAR was 13.0% (2010 -12.9%). For further information refer to Balance sheet management: Capital management on pages 68 to 73.

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Risk and balance sheet management

In this section (pages 58 to 207) of the Business review, certain information has been audited and is part of the Group's financial statements as permitted by IFRS 7. Other disclosures are unaudited and are labelled with an asterisk (*). In this section, the 2009 data relate to the Group before RFS Holdings minority interest (RFS MI).

Introduction*

All the disclosures in this section (pages 58 to 67) are unaudited as indicated by an asterisk (*).

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

Financial strength and resilience are at the heart of the Group's Strategic Plan. The 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 Group Board set out four key strategic risk objectives, aligned to the Group's Strategic Plan. These are to:

- maintain capital adequacy: to ensure that the Group has sufficient (and easily accessible) 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 over the previous five years;

- ensure stable and efficient access to funding and liquidity: such that the 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; and

- maintain stakeholder confidence: to ensure that stakeholders have confidence in the 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.

These strategic risk objectives are the bridge between the 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.

In 2011, the Group made significant progress in strengthening its approach to risk management in an external environment that remained challenging.

The task of setting a comprehensive risk appetite and aligning it with the Group's business strategy demands a clear understanding of the types of risk the Group faces and their potential size. With this goal in mind, over the past year the Group has developed a catalogue of the risks it faces (a risk taxonomy) and undertaken a Group-wide material risk assessment to analyse the scale of each risk and the potential interactions between them (for a detailed discussion of risk appetite, see page 59).

The delivery of proactive and effective risk management relies on high quality data inputs on which to make assessments. It also requires robust forward-looking measurement and stress testing capabilities (see stress testing on page 60). Both of these areas continue to be enhanced and improvements embedded across the Group.

Risk control frameworks are used to identify and address concentrations of risk. These systems are reinforced by a Group Policy Framework (see page 60), which was enhanced during 2011, with assurance activity ongoing to ensure the policy standards it comprises remain appropriate.

Effective risk management also requires a robust governance framework. During 2011, the roles and responsibilities of the Executive Risk Forum and its supporting committees were reviewed and more clearly defined (see pages 62 to 64).

The Group has launched a common set of values for the risk community that impact directly on behaviours and help to engender a risk management function that is widely respected and valued across the Group. A Group-wide policy that explicitly aligns remuneration with effective risk management has also been put in place.

The focus is now on fully embedding the Group's strategy for risk management into the day-to-day management of its businesses, as well as preparing the Group to face future challenges in a rapidly evolving external environment. More detailed discussions on how the Group strengthened its approach to risk management in 2011 and the areas of focus going forward is contained within the relevant sub-sections on the following pages.

* unaudited

Risk appetite*

The Group's focus on setting a clear risk appetite and embedding a strong culture of risk management and control is designed to ensure it is able to proactively identify and reduce risk exposures and has the resilience to respond effectively to any unforeseen shocks.

The Group's risk appetite identifies and establishes the level and type of risks that it is able and willing to take in order to:

- meet its strategic objectives - this includes the Group's stated objective of achieving and sustaining a standalone credit rating in line with those of its strongest international peers; and

- meet its wider obligations to stakeholders - the Group's Strategic Plan is built on the core foundations of serving its customers well, acting responsibly and creating sustainable value for its shareholders.

A clear risk appetite provides a greater understanding across the Group of the acceptable levels of risk for each business. It provides a solid platform from which the Group can focus on its key business strengths and competitive advantages over the long-term.

Approach and key principles

The Strategic Plan set key performance indicators for capital, leverage, liquidity and funding, aligned with the Group's strategic objectives. It also established a Non-Core division to manage, dispose of and run-off assets that the Group was seeking to exit from, which by definition were outside its appetite.

Building on these core foundations, the Group has developed a framework that sets and implements an appropriate risk appetite for the Group (and its main businesses), supported by a regular monitoring and review process.

Under this framework, risk appetite targets - based on both the quantitative and qualitative aspects of risk - have been set by the Group Board, aligned with Group and divisional strategic objectives. These targets support and augment the strategic, financial and risk controls that are already in place and help to shape the way the Group operates at all levels. Clear roles and responsibilities are established to measure, cascade and report performance against risk appetite and to provide assurances that business is being conducted within approved risk limits and tolerances.

The development of this framework has been based on the following best practice principles:

- strong leadership from the Group Board in establishing and setting risk appetite and in ensuring its purpose is understood and its use promoted as good business practice;

- a strong risk management culture, in which risk is clearly and meaningfully aligned with business behaviours and outcomes;

- a close collaborative partnership between the risk, strategy, treasury and finance functions that facilitates a broader internal debate on key issues; and

- clear accountability by each division (and business unit) for the level of risk it is prepared to take to achieve its business objectives.

Group-wide stress testing is used to assess whether strategic plans are consistent with risk appetite and to measure the key drivers of risk (down to business unit level), with mitigating actions identified whenever the risk profile is considered to be outside (or close to) acceptable levels (see page 60).

Design to delivery

The Group's risk appetite has been set by the Group Board and is now operational. Significant progress has been made in establishing the underlying framework and rolling it out across the Group and its divisions.

The key channels through which risk appetite is cascaded throughout and embedded in each division are:

- divisional risk appetite statements - each division has developed its own risk appetite statement, which is based on the four strategic risk objectives and is appropriate for its business plans but also aligned with the Group's risk appetite targets;

- risk control frameworks and limits - risk control frameworks set clear guidance on acceptable limits and tolerances for all material risk types (e.g. credit, market and country risk), aligned with the Group's risk appetite targets;

- Group operational and conduct risk appetite - the Group has developed a robust control environment to ensure it conducts its activities in accordance with its regulatory and other obligations; and

- culture, values and remuneration - a programme of communication, engagement and training is being rolled out across the Group to engender a wide understanding of the purpose of risk appetite.

The Group regards the implementation of its risk appetite framework as an essential step in driving the cultural change required to achieve its strategic objectives and a dynamic, ongoing process. The Board Risk Committee (see the Report of the Board Risk Committee on pages 226 to 229) reviews both the targets and the framework on a regular basis, to ensure they remain aligned to strategic objectives, business performance, emerging risks and changes in the external environment.

* unaudited

Business review Risk and balance sheet management continued

Introduction*: Stress testing
Stress testing describes the evaluation of a bank's financial position under severe but plausible stress scenarios. Stress testing refers to the application of individual stress tests and 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.

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

The Executive Risk Forum (see Risk governance on page 61) is the main body overseeing the Group's stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any Group-wide stress test and ensuring that, where necessary, appropriate management actions are undertaken. The Board Risk Committee will provide oversight and challenge as appropriate.

Stress testing forms part of the Group's risk and capital management framework and is a major component of the Basel III requirements. It highlights to senior management potential adverse unexpected outcomes related to a mixture of risks and provides an indication of how much capital might be required to absorb losses should adverse scenarios materialise.

Stress testing is used at both divisional and Group levels to assess risk concentrations and estimate the impact of stressed earnings, impairments and write-downs on capital as well as the liquidity and funding position of the Group. It determines overall capital adequacy under a variety of adverse scenarios.

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

- macroeconomic stress testing, which considers the impact on both earnings and capital for a range of scenarios;
- enterprise-wide stress testing, which considers scenarios that are not macroeconomic in nature but are sufficiently broad to entail multiple risks or affect multiple divisions and are likely to affect earnings, capital and funding;
- cross-divisional stress testing, which includes scenarios that affect multiple divisions due to their sensitivity to a common risk factor; and
- divisional and risk-specific stress testing, which is undertaken to support risk identification and management.

Portfolio analysis, using historical performance and forward-looking indicators of change, uses stress testing to assess potential exposure to events and seeks to quantify the impact of an adverse change in factors that drive the performance and profitability of a portfolio.

Industry-wide stress tests
The Group takes part in a number of industry-wide stress tests, in particular, the European Banking Authority Stress Test and IMF UK Financial Sector Assessment Program, results of which were published in July 2011. These confirmed that the Group remains well capitalised with a strong Core Tier 1 capital ratio and a strong Total capital

ratio under both baseline and adverse scenarios. During 2011, the Group also undertook the FSA anchor scenario test.

In December 2011, the European Banking Authority published the results of its recapitalisation exercise - a review of banks' actual capital positions on sovereign exposures - showing the Group had no overall capital shortfall after including the sovereign capital buffer.

Group Policy Framework*

Achieving and sustaining a robust control framework in line with those of the Group's strongest international peers is critical to achieving the successful delivery of the Group's risk objectives.

With this goal in mind, the Group Policy Framework (GPF) has been revised and broadened. The GPF consolidates a large number of individual policies under a consistent and structured overarching framework for conduct, control and governance. It provides clear guidance and controls on how the Group does business, linked to its risk appetite, its business conduct and compliance responsibilities and its focus on delivering a control environment consistent with best practice against relevant external benchmarks.

The GPF and related initiatives aim to ensure that:

- the Group has clear control standards and ethical principles to cover the risks that it faces to support effective risk management and meet regulatory and legal requirements;
- policies are followed across the Group and compliance can be clearly evidenced, assessed and reported by line management; and
- the control environment is monitored and overseen through good governance.

Communication and training programmes are provided to all relevant staff as the policies are embedded, ensuring that staff are aware of their responsibilities. The GPF is structured to ensure that policy standard owners and sponsors review their policies on a regular basis, with any identified shortfalls against industry best practice documented and addressed within an agreed time frame.

* unaudited

The GPF was introduced in 2009. Enhancements applied in 2011 included the following:

- the Group's policy standards, which comprise the GPF, were rewritten to ensure they clearly express the mandatory controls required to mitigate the key risks the Group faces;

- all of the Group's policy standards were benchmarked against relevant external reference points such as peer organisations to challenge and verify the content of the policy standards. Where identified, further improvements to the policy standards are now being implemented;

- for each policy standard, appropriate risk based assurance activity was introduced to ensure each division is appropriately controlled and compliance with policy can be demonstrated; and

- risk appetite has its own policy standard within the GPF that clearly sets out roles and responsibilities in relation to the implementation of the risk appetite framework and provides assurance that risks are being actively managed within approved levels and tolerances.

The GPF will continue to be improved and embedded. The results of assurance activity, monitoring and analysis of the internal and external environment will be used to reassess the policy standards on a regular basis.

Risk governance*
The Group is committed to the highest standards of corporate governance in every aspect of the business, including risk management. A key aspect of the Group Board's responsibility as the main decision making body at Group level is the setting of Group risk appetite to ensure that the levels of risk that the Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood.

To enable the Group Board to carry out its objectives, it has delegated authority to senior Board and executive committees, as required and appropriate. A number of key committees specifically consider risk across the Group, as set out in the diagram below.

Notes:
(1) The Capital and Stress Testing Committee is a sub-committee of the Group Asset and Liability Management Committee.
(2) The following specialist sub-committees report directly to the Group Risk Committee: Global Markets Risk Committee, Group Country Risk Committee, Group Models Committee, Group Credit Risk Committee and Operational Risk Executive Committee. In addition, Divisional Risk Committees report to the Group Risk Committee.

* unaudited

Business review Risk and balance sheet management continued

Introduction*: Risk governance continued
The key risk responsibilities of each of these committees as well as their membership are set out in the table below. Further information on the Group Board and Board Committees is available on page 210.

These committees are supported at a divisional level by a risk governance structure embedded in the business. These committees play a key role in ensuring that the Group's risk appetite is supported by effective risk management frameworks, limits and policies, together with clear accountabilities for approval, monitoring, oversight, reporting and escalation.

During 2011, the roles and responsibilities of the Executive Risk Forum and its supporting committees were reviewed and more clearly defined, to meet the future needs of the Group.

In particular, the Executive Risk Forum was repositioned as a strategic committee focusing on strategic level risks and issues, and retaining the approval authority for the most material risk limits and decisions. The Group Risk Committee was refocused to operate primarily as an oversight committee across risk types, concentrating particularly on thematic and emerging risks and issues.

The committees that sit below the Group Risk Committee were streamlined significantly, aligned more closely to key risk types and given clearer empowerment and accountability where required.

A Capital and Stress Testing Committee was created as a sub-committee of the Group Asset and Liability Management Committee to cover risk and capital matters.

The improvements made in 2011 provide further clarity of roles and responsibilities, as well as clear reporting lines and accountabilities. They promote clearer and timelier decision making and more effective risk management and oversight.

The role and remit of the Group committees is set out below. These committees are supported at a divisional level by a risk governance structure embedded in the business.

Board/Committee	Risk focus	Membership
Group Board	The Group Board ensures that the Group manages risk effectively through approving and monitoring the Group's risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer-term strategic threats to the Group's business operations.	The Board of directors
Executive Committee	The Executive Committee considers recommendations on risk management matters referred by the Executive Risk Forum and/or Group Risk Committee, including recommendations on risk appetite, risk policies and risk	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers of divisions Head of Restructuring and Risk

	management strategies.	
Board Risk Committee	The Board Risk Committee provides oversight and advice to the Group Board on current and potential future risk exposures of the Group and future risk strategy, including determination of risk appetite and tolerance. It also provides a risk review of remuneration arrangements and provides advice to the Remuneration Committee. It operates under delegated authority from the Group Board.	At least three independent non-executive directors, one of whom is the Chairman of the Group Audit Committee.

* unaudited

Board/Committee	Risk focus	Membership
Group Audit Committee	The Group Audit Committee reviews accounting policies and practices, controls and procedures established by management for compliance with regulatory and financial reporting requirements and requirements of external regulations. It has responsibility for monitoring relationships with regulatory authorities. It operates under delegated authority from the Group Board.	At least three independent non-executive directors, at least one of whom is a financial expert as defined in the SEC rules under the US Exchange Act and one of whom is Chairman of the Board Risk Committee.
Group Remuneration Committee	The Group Remuneration Committee is responsible for the overview of the Group's policy on remuneration and receives advice from Risk Management and the Board Risk Committee to ensure that there is thorough risk input into incentive plan design and target setting as well as risk review of performance bonus pools and clawback. It operates under delegated authority from the Group Board.	At least three independent non-executive directors
Executive Risk Forum	The Executive Risk Forum operates as a committee of the Executive Committee with full authority to act on all risk and control matters across the Group. The Executive Risk Forum approves the most material limits and decisions above defined thresholds and delegates decisions below these thresholds to sub-committees and appropriate individuals.	Group Chief Executive Group Finance Director Chief Administrative Officer Chief Executive Officers of divisions Head of Restructuring and Risk Deputy Chief Risk Officer
Group Asset and Liability Management Committee	The Group Asset and Liability Management Committee (GALCO) is a sub-committee of the Executive Risk Forum and is responsible for identifying, managing and controlling Group balance sheet risks in executing its chosen business strategy.	Group Finance Director Group Treasurer Chief Executive Officers of divisions Head of Restructuring and Risk Key Group Finance function heads Global Head of Markets
Group Risk Committee	The Group Risk Committee is a sub-committee of the Executive Risk Forum. It is an oversight committee which reviews and challenges risks and limits across the functional areas and plays a key role exercising and demonstrating effective risk oversight across the Group.	Deputy Chief Risk Officer Divisional Chief Risk Officers Key Group Risk function heads

It reviews risks and issues on a thematic as well as a specific basis and focuses on forward-looking, emerging risks. It considers the overall risk profile across the Group and identifies any key issues for escalation to the Executive Risk Forum.

* unaudited

Business review Risk and balance sheet management continued

Introduction*: Risk governance continued

Board/Committee	Risk focus	Membership
Capital and Stress Testing Committee	The Capital and Stress Testing Committee is a sub-committee of the Group Asset and Liability Management Committee and focuses on the broad risk capital agenda, including risk appetite, capital usage, stress testing, Internal Capital Adequacy Assessment Process, capital planning, allocation and management, economic capital and prudential developments, including Basel oversight.	Group Finance Director Key Group Finance function heads Key Group Risk function heads
Executive Credit Group	The Executive Credit Group decides on requests for the extension of existing or new credit limits on behalf of the Group Board where the proposed aggregate facility limits are in excess of the credit approval authorities granted to individuals in divisions or in Group Risk Management, or where an appeal against a decline decision of the Group Chief Credit Officer (or delegates) or Group Chief Risk Officer is referred for final decision.	Group A members (1) Head of Restructuring and Risk Deputy Chief Risk Officer Group Chief Credit Officer/Chief Credit Officer N.V. Head of Global Restructuring Group Chief Risk Officer, Non-Core division/APS (alternate) Group B members (1) Group Chief Executive Group Finance Director Chief Executive officers of divisions (1) Decisions require input from at least one member from each of Group A and Group B.
Divisional Risk and Audit Committees	Divisional Risk and Audit Committees report to the Board Risk Committee and the Group Audit Committee on a quarterly basis. Their main responsibilities are to: · monitor the performance of the divisions relative to divisional and Group risk appetite; · review matters relative to accounting policies, internal control, financial reporting, internal audit, external audit and regulatory compliance as set out in their terms of reference; and	Members: at least three non-executive members who are executives of the Group who do not have executive responsibility in the relevant division. Attendees: at least two executives of the division, as appropriate. Representatives from finance, risk, internal audit and external audit. Members of the Board Risk Committee and Group Audit Committee also have the right to attend.

- assist on such other matters as may be referred to them by the relevant divisional Executive Committee, the Group Audit Committee or the Board Risk Committee.

* unaudited

Introduction*:Risk coverage
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 2011.

Risk type	Definition	Features	How the Group managed risk and the focus in 2011
Capital, liquidity and funding risk	The risk that the Group has insufficient capital or is unable to meet its financial liabilities as they fall due.	Potential to disrupt the business model and stop normal functions of the Group. Potential to cause the Group to fail to meet the supervisory requirements of regulators. Significantly driven by credit risk losses.	The Group plans for and maintains an adequate amount and mix of capital consistent with its risk profile. This ensures that in any foreseeable scenario the Group holds minimum capital to meet the standards and requirements of investors, regulators and depositors. The amount of capital required is determined through risk assessments and stress testing. Active run-off of capital intensive assets in Non-Core and other risk mitigation left the Core Tier 1 ratio strong at 10.6%, despite a £21 billion uplift in RWAs from the implementation of CRD III in December 2011. Refer to pages 68 to 73. Maintaining the structural integrity of the Group's balance sheet requires active management of both asset and liability portfolios as necessary. Strong term debt issuance and planned reductions in the funded balance sheet enabled the Group to strengthen its liquidity and funding position as market conditions worsened. Refer to pages 74 to 88.
Credit risk (including counterparty risk)	The risk that the Group will incur losses owing to the failure of a customer to meet its obligation to settle outstanding amounts.	Loss characteristics vary materially across portfolios. Significant link between losses and the macroeconomic environment. Can include concentration risk - the risk of loss due to the concentration of credit risk to a specific product, asset class, sector or counterparty.	The Group manages credit risk based on a suite of credit approval and risk concentration frameworks and associated risk management systems and tools. It also continues to reduce the risk associated with legacy exposures through further reductions in Non-Core assets. During 2011, asset quality continued to improve, resulting in loan impairment charges 21% lower than in 2010 despite continuing challenges in Ulster Bank Group (Core and Non-Core) and corporate real estate portfolios. The Group continued to make progress in reducing key credit concentration risks, with credit exposures in excess of single name concentration limits

			declining 15% during the year and exposure to commercial real estate declining 14%. Refer to pages 92 to 165.
Country risk	The risk of material losses arising from significant country-specific events.	Can arise from sovereign events, economic events, political events, natural disasters or conflicts. Potential to affect parts of the Group's credit portfolio that are directly or indirectly linked to the country in question.	All country exposures are covered by the Group's country risk management framework. This includes active management of portfolios either when these have been identified as exhibiting signs of stress through the Group's country Watchlist process or when it is otherwise considered appropriate. Portfolio reviews are undertaken to align country risk profiles to the Group's country risk appetite in light of economic and political developments. Sovereign risk increased in 2011, resulting in rating downgrades for a number of countries, including several eurozone members. This resulted in an impairment charge recognised by the Group in 2011 in respect of available-for-sale Greek government bonds. In response, the Group further strengthened its country risk appetite setting and risk management systems during the year and brought a number of advanced countries under limit control. This contributed to a reduction in exposure to a range of countries. Refer to pages 166 to 186.

* unaudited

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Business review Risk and balance sheet management continued

Introduction*: Risk coverage continued

Risk type	Definition	Features	How the Group managed risk and the focus in 2011
Market risk	The risk arising from changes in interest rates, foreign currency, credit spreads, equity prices and risk related factors such as market volatilities.	Frequent small losses which are material in aggregate. Infrequent large material losses due to stress events.	A comprehensive structure is in place aimed at ensuring the Group does not exceed its qualitative and quantitative tolerance for market risk. The Group's market risk policy statements set out its qualitative tolerance for market risk. They define the governance, responsibilities and requirements for the identification, measurement, analysis, management and communication of the market risk arising from the Group's trading and non-trading investment activities. The Group Market Risk limit framework expresses the Group's quantitative tolerance for market risk. The Group limit metrics capture, in broad terms, the full range of market risk exposures, ensuring the risk is appropriately defined and communicated. During 2011, the Group continued to manage down its market risk exposure in Non-Core and reduce the asset-backed securities trading inventory such that the trading portfolio became less exposed to credit risk. Refer to pages 187 to 193.
Insurance risk	The risk of financial loss through fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations at the time of underwriting.	Frequent small losses which are material in aggregate. Infrequent large material losses.	The Group's framework for managing insurance risk, with associated risk appetite and policy frameworks, is designed to ensure insurance risks are appropriately identified, controlled, managed, monitored, reported and mitigated. Procedures are in place to address any issues, such as breaches of risk appetite that are identified through monitoring and reporting activities. If a breach occurs, an action plan to address the issue is developed, implemented and monitored to ensure the risk is adequately mitigated or a decision is taken to accept it.

			During 2011, focus on insurance risk appetite resulted in the de-risking and significant re-pricing of certain classes of business and exiting some altogether. Refer to page 194.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent material losses.	The objective of operational risk management is to manage it to an acceptable level. Processes to achieve this objective take into account the cost of minimising the risk against the resultant reduction in exposure. During 2011, the Group took steps to enhance its management of operational risks. This was particularly evident in respect of risk appetite, the Group Policy Framework, risk assessment, scenario analysis and statistical modelling for capital requirements. The level of operational risk remains high due to the scale of structural change occurring across the Group, the pace of regulatory change, the economic downturn and other external threats, such as e-crime. Refer to pages 194 to 197.

* unaudited

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Risk type	Definition	Features	How the Group managed risk and the focus in 2011
Compliance risk	The risk arising from non-compliance with national and international laws, rules and regulations.	Adverse impacts on strategy, capital structure, business models and operational effectiveness. Financial cost of adapting to changes in laws, rules or regulations or of penalties for non-compliance.	Management of compliance risk entails early identification and effective management of changes in legislative, regulatory and other requirements that may affect the Group. It also requires active engagement with regulators, close analysis of emerging regulatory themes, and interaction with rule-makers and legislators. Within the GPF, compliance risk policies define minimum standards to which all businesses must adhere. GPF policies are supplemented, where appropriate, by divisional policies to meet local product or market requirements. During 2011, the Group managed the increased levels of scrutiny and legislation by enlarging the capacity of its compliance, anti-money laundering and regulatory affairs teams and taking steps to improve its operating models, tools, systems and processes. Refer to pages 197 to 202.
Reputational risk	The risk of brand damage arising from financial and non-financial events arising from the failure to meet stakeholders' expectations of the Group's performance and behaviour.	Potential to put the entire business at risk. Otherwise, could lead to negative publicity, loss of revenue, costly litigation or a decline in customer base. Can arise from actions taken by the Group or a failure to take action.	The Group Sustainability Committee and risk committees continue to assess reputational risk issues. In 2011, an Environmental, Social and Ethical (ESE) Risk Policy was developed with sector ESE risk appetite positions drawn up to assess the Group's appetite to support customers in sensitive sectors including defence, oil and gas. This also included the establishment of divisional reputational risk committees. Stakeholder engagement was broadened with the implementation of formal sessions between the Group Sustainability Committee and relevant advocacy groups and non-governmental organisations. Refer to page 202.
Business risk	The risk of lower-than-expected revenues and/or	Influenced by many factors such as pricing, sales volume,	Forecasts of revenues and costs are tested against a range of stress scenarios to identify key risk drivers and the

	higher-than-expected operating costs.	input costs, regulations and market and economic conditions.	appropriate actions to address and manage them. Business risk is incorporated within the Group's risk appetite target for earnings volatility that was set in 2011. Refer to page 202.
Pension risk	The risk that the Group will have to make additional contributions to its defined benefit pension schemes.	Funding position can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities.	The Group manages pension risk from a sponsor perspective using a framework that encompasses risk reporting and monitoring, stress testing, modelling and an associated governance structure that helps ensure the Group is able to fulfil its obligation to support the defined benefit pension schemes to which it has exposure. In 2011, the Group focused on improved stress testing and risk governance mechanisms. This included the establishment of the Pension Risk Committee and the articulation of its view of risk appetite for the various Group pension schemes. Refer to pages 203 and 204.

Each risk type maps into the Group's risk appetite framework and contributes to the overall achievement of its strategic objectives with underlying frameworks and limits. The key frameworks and developments over the past year are described in the relevant sections of the following pages.

* unaudited

Balance sheet management
All disclosures in this section (pages 68 to 91) are audited unless otherwise indicated by an asterisk (*).

Two of the Group's four key strategic risk objectives relate to the maintenance of capital adequacy and ensuring stable and efficient access to liquidity and funding. This section on balance sheet management explains how the Group is performing on achieving these objectives.

Capital management
Introduction*
The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements as capital adequacy and risk management are closely aligned. The Group operates within an agreed risk appetite whilst optimising the use of shareholders' funds to deliver sustainable returns.

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 investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

Governance*
The Group Asset and Liability Management Committee (GALCO) is responsible for ensuring the Group maintains adequate capital at all times. The newly established Capital and Stress Testing Committee (CAST) is a cross-functional body driving and directing integrated risk capital activities including stress testing economic capital and capital allocation. 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.

Determining appropriate capital*
The minimum regulatory capital requirements are identified by the Group through the Internal Capital Adequacy Assessment Process and then agreed between the Group Board and the appropriate supervisory authority.

The Group's own determination of how much capital is sufficient is derived from the desired credit rating level and the application of both internally and externally defined stress tests that identify potential changes in capital ratios over time.

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 deteriorates 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 remains adequately capitalised.

Capital allocation*

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

Economic profit is also planned and measured for each division during the annual planning process. It is calculated by deducting the cost of equity utilised in the particular business from its operating profit and measures the value added over and above the cost of equity.

The Group aims to deliver sustainable returns across the portfolio of businesses with projected business returns stressed to test key vulnerabilities.

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

The FSA 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); by international agreement the risk asset ratios should not be less than 8% with a Tier 1 component of not less than 4%.

* unaudited

Capital adequacy*

The Group's RWAs and risk asset ratios, calculated in accordance with FSA definitions, are set out below.

	Statutory			Proportional
	2011	2010	2009	2009
Risk-weighted assets by risk	£bn	£bn	£bn	£bn
Credit risk	344.3	385.9	513.2	410.4
Counterparty risk	61.9	68.1	56.5	56.5
Market risk	64.0	80.0	65.0	65.0
Operational risk	37.9	37.1	33.9	33.9
	508.1	571.1	668.6	565.8
Asset Protection Scheme relief	(69.1)	(105.6)	(127.6)	(127.6)
	439.0	465.5	541.0	438.2
Risk asset ratios	%	%	%	%
Core Tier 1	10.6	10.7	11.0	11.0
Tier 1	13.0	12.9	14.1	14.4
Total	13.8	14.0	16.1	16.3

Key points*

- Market risk RWAs were impacted by the new CRD III rules but decreased overall by £16 billion in 2011 reflecting de-risking of Non-Core and a reduction in trading VaR.

- APS relief decreased by £36.5 billion, reflecting pool movements, assets moving into default and changes in risk parameters.

Pillar 3*

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

* unaudited

Business review Risk and balance sheet management continued

Balance sheet management: Capital management continued

Capital resources

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

	Statutory			Proportional*
	2011	2010	2009	2009
Shareholders' equity (excluding non-controlling interests)	£m	£m	£m	£m
Shareholders' equity per balance sheet	74,819	75,132	77,736	77,736
Preference shares - equity	(4,313)	(4,313)	(7,281)	(7,281)
Other equity instruments	(431)	(431)	(565)	(565)
	70,075	70,388	69,890	69,890
Non-controlling interests				
Non-controlling interests per balance sheet	1,234	1,719	16,895	2,227
Non-controlling preference shares	(548)	(548)	(656)	(656)
Other adjustments to non-controlling interests for regulatory purposes	(259)	(259)	(497)	(497)
	427	912	15,742	1,074
Regulatory adjustments and deductions				
Own credit	(2,634)	(1,182)	(1,057)	(1,057)
Unrealised losses on AFS debt securities	1,065	2,061	1,888	1,888
Unrealised gains on AFS equity shares	(108)	(25)	(134)	(134)
Cash flow hedging reserve	(879)	140	252	252
Other adjustments for regulatory purposes	571	204	(193)	41
Goodwill and other intangible assets	(14,858)	(14,448)	(17,847)	(14,786)
50% excess of expected losses over impairment provisions (net of tax)	(2,536)	(1,900)	(2,558)	(2,558)
50% of securitisation positions	(2,019)	(2,321)	(1,353)	(1,353)
50% of APS first loss	(2,763)	(4,225)	(5,106)	(5,106)
	(24,161)	(21,696)	(26,108)	(22,813)
Core Tier 1 capital	46,341	49,604	59,524	48,151
Other Tier 1 capital				
Preference shares - equity	4,313	4,313	7,281	7,281
Preference shares - debt	1,094	1,097	3,984	3,984
Innovative/hybrid Tier 1 securities	4,667	4,662	5,213	2,772
	10,074	10,072	16,478	14,037
Tier 1 deductions				
50% of material holdings	(340)	(310)	(601)	(310)
Tax on excess of expected losses over impairment provisions	915	758	1,020	1,020
	575	448	419	710
Total Tier 1 capital	56,990	60,124	76,421	62,898

* unaudited

	Statutory			Proportional*
	2011	2010	2009	2009
Qualifying Tier 2 capital	£m	£m	£m	£m
Undated subordinated debt	1,838	1,852	4,950	4,200
Dated subordinated debt - net of amortisation	14,527	16,745	20,063	18,120
Reserves arising on revaluation of property	—	—	73	73
Unrealised gains on AFS equity shares	108	25	134	134
Collectively assessed impairment provisions	635	778	796	796
Non-controlling Tier 2 capital	11	11	11	11
	17,119	19,411	26,027	23,334
Tier 2 deductions				
50% of securitisation positions	(2,019)	(2,321)	(1,353)	(1,353)
50% excess of expected losses over impairment provisions	(3,451)	(2,658)	(3,578)	(3,578)
50% of material holdings	(340)	(310)	(601)	(310)
50% of APS first loss	(2,763)	(4,225)	(5,106)	(5,106)
	(8,573)	(9,514)	(10,638)	(10,347)
Total Tier 2 capital	8,546	9,897	15,389	12,987
Supervisory deductions				
Unconsolidated investments				
- Direct Line Group	(4,354)	(3,962)	(4,068)	(4,068)
- Other investments	(239)	(318)	(404)	(404)
Other deductions	(235)	(452)	(93)	(93)
	(4,828)	(4,732)	(4,565)	(4,565)
Total regulatory capital (1)	60,708	65,289	87,245	71,320

	2011
Movement in Core Tier 1 capital	£m
At beginning of the year	49,604
Attributable loss net of movements in fair value of own debt	(3,449)
Foreign currency reserves	(363)
Decrease in non-controlling interests	(485)
Decrease in capital deductions including APS first loss	1,128
Other movements	(94)
At end of the year	46,341

Note:

(1) Total capital includes certain instruments issued by RBS N.V. Group that are treated consistent with the local implementation of the Capital Requirements Directive (including the transitional provisions of that Directive). The FSA formally confirmed this treatment in 2012.

* unaudited

Business review Risk and balance sheet management continued

Balance sheet management: Capital management continued
Risk-weighted assets by division*
Risk-weighted assets by risk category and division are set out below:

2011	Credit risk £bn	Counterparty risk £bn	Market risk £bn	Operational risk £bn	Gross RWAs £bn
UK Retail	41.1	-	-	7.3	48.4
UK Corporate	71.2	-	-	8.1	79.3
Wealth	10.9	-	0.1	1.9	12.9
International Banking	38.9	-	-	4.3	43.2
Ulster Bank	33.6	0.6	0.3	1.8	36.3
US Retail & Commercial	53.6	1.0	-	4.7	59.3
Retail & Commercial	249.3	1.6	0.4	28.1	279.4
Markets	16.7	39.9	50.6	13.1	120.3
Other	9.8	0.2	-	2.0	12.0
Core	275.8	41.7	51.0	43.2	411.7
Non-Core	65.6	20.2	13.0	(5.5)	93.3
Group before RFS MI	341.4	61.9	64.0	37.7	505.0
RFS MI	2.9	-	-	0.2	3.1
Group	344.3	61.9	64.0	37.9	508.1
APS relief	(59.6)	(9.5)	-	-	(69.1)
Net RWAs	284.7	52.4	64.0	37.9	439.0
2010					
UK Retail	41.7	-	-	7.1	48.8
UK Corporate	76.4	-	-	7.8	84.2
Wealth	10.4	-	0.1	2.0	12.5
International Banking	44.0	-	-	7.7	51.7
Ulster Bank	29.2	0.5	0.1	1.8	31.6
US Retail & Commercial	52.1	0.9	-	4.4	57.4
Retail & Commercial	253.8	1.4	0.2	30.8	286.2
Markets	21.5	34.5	44.7	9.6	110.3
Other	16.4	0.3	0.2	1.0	18.0
Core	291.7	36.3	45.1	41.4	414.5
Non-Core	91.3	31.8	34.9	(4.3)	153.7
Group before RFS MI	383.0	68.1	80.0	37.1	568.2
RFS MI	2.9	-	-	-	2.9
Group	385.9	68.1	80.0	37.1	571.1
APS relief	(88.2)	(17.4)	-	-	(105.6)
Net RWAs	297.7	50.7	80.0	37.1	465.5

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

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

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

* unaudited

Regulatory capital impact of the APS*

Methodology

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

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

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

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

Impact

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

Future regulatory capital effects

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

For further information on the assets covered by APS see pages 205 to 207.

Basel III*

The rules issued by the Basel Committee on Banking Supervision (BCBS), commonly referred to as Basel III, are a comprehensive set of reforms designed to strengthen the regulation, supervision, risk and liquidity management of the banking sector. In the EU they will be enacted through a revised Capital Requirements Directive referred to as CRD IV.

In December 2010, the BCBS issued the final text of the Basel III rules, providing details of the global standards agreed by the Group of Governors and Heads of Supervision, the oversight body of the BCBS and endorsed by the G20 leaders at their November 2010 Seoul summit. There are transition arrangements proposed for implementing these new standards as follows:

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

The Group, in conjunction with the FSA, regularly evaluates its models for the assessment of RWAs ascribed to credit risk across various classes. This, together with the changes introduced by CRD IV relating primarily to counterparty risk, is expected to increase RWA requirements by the end of 2013 by £50 billion to £65 billion. These estimates are still subject to change; a degree of uncertainty remains around implementation details as the guidelines are not finalised and must still be enacted into EU law. There could be other future changes and associated impacts from these model reviews.

Other regulatory capital changes*

The Group is in the process of implementing changes to the RWA requirements for commercial real estate portfolios consistent with revised industry guidance from the FSA. This is projected to increase RWA requirements by circa £20 billion by the end of 2013, of which circa £10 billion will apply in 2012.

The Group is managing the changes to capital requirements from new regulation and model changes and the resulting impact on the common equity Tier 1 ratio, focusing on risk reduction and deleveraging. This is principally being achieved through the continued run-off and disposal of Non-Core assets and deleveraging in Markets as the business focuses on the most productive returns on capital.

The major categories of new deductions and regulatory adjustments which are being phased in over a five year period from 1 January 2014 include:

- Expected loss net of provisions;
- Deferred tax assets not relating to timing differences;
- Unrealised losses on available-for-sale securities; and
- Significant investments in non-consolidated financial institutions.

The net impact of these changes is expected to be manageable as the aggregation of these drivers is projected to be lower by 2014 and declining during the phase-in period.

* unaudited

Balance sheet management: Liquidity and funding risk

All disclosures in this section (pages 74 to 91) are audited unless otherwise indicated with an asterisk (*).

Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its obligations, including financing maturities as they fall due. Liquidity risk is heavily influenced by the maturity profile and mix of the Group's funding base, as well as the quality and liquidity value of its liquidity portfolio.

Liquidity risk is dynamic, being influenced by movements in markets and perceptions that are driven by firm specific or external factors. Managing liquidity risk effectively is a key component of the Group's risk reduction strategy. The Group's 2011 performance demonstrates continued improvements in managing liquidity risk and reflects actions taken in light of an uncertain economic outlook, which resulted in improvements in key measures:

- Deposit growth - Core Retail & Commercial deposits increased, and together with Non-Core deleveraging, took the Group loan:deposit ratio to 108%, compared with 118% at the end of 2010.

- Wholesale funding - £21 billion of net term wholesale debt was issued in 2011 from secured and unsecured funding programmes, across a variety of maturities and currencies.

- Short-term wholesale funding (STWF) - the overall level of STWF fell by £27 billion to £102 billion, below the 2013 target of circa £125 billion.

- Liquidity portfolio - the liquidity portfolio of £155 billion was maintained above the 2013 target level of £150 billion against a backdrop of heightened market uncertainty in the second half of the year and was higher than STWF. This represents a £53 billion cushion over STWF.

Funding issuance

The Group has access to a variety of funding sources across the globe, including short-term money markets, repurchase agreement markets and term debt investors through its secured and unsecured funding programmes. Diversity in funding is provided by its active role in the money markets, along with access to global capital flows through its international client base. The Group's wholesale funding franchise is well diversified by currency, geography, maturity and type.

The Group has been a regular issuer in the debt capital markets in both secured and unsecured arrangements. 2011 net new term debt issuance was £21 billion, with 49% secured and 51% unsecured, of which 71% were public transactions and 29% were private.

Balance sheet composition

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 liquidity transformation in normal business environments, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

Diversification of the Group's funding base is central to its balance sheet management strategy. The Group's businesses have developed large customer franchises based on strong relationship management and high quality service. These customer franchises are strongest in the UK, the US and Ireland, but extend into Europe and Asia. Customer deposits provide large pools of stable funding to support the majority of the Group's lending. Improvement of the Group's loan:deposit ratio to 100% or better, by 2013, is a strategic objective.

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

Stress testing
The strength of a bank’s liquidity risk management can only be evaluated based on its ability to survive under stress. The Group evaluates the survivability of the major legal entities and legal entity groups when subjected to simulated stress conditions.

Simulated liquidity stress testing is periodically performed for each business as well as the major operating subsidiaries. A variety of firm-specific and market-related scenarios are used at the consolidated level and in individual countries. These scenarios include assumptions about significant changes in key funding sources, credit ratings, contingent uses of funding, and political and economic conditions in certain countries.

The Group’s actual experiences from the 2008 and 2009 period factor heavily into the liquidity analysis. This systemic and name-specific crisis provides important data points in estimating stress severity.

Stress scenarios are applied to both on-balance sheet and off-balance sheet commitments, to provide a comprehensive view of potential cash flows.

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

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

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

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

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

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

In December 2010, the Basel Committee on Banking Supervision issued the 'International framework for liquidity risk measurement, standards and monitoring' which confirmed the introduction of two liquidity ratios: the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

The introduction of both of these ratios will be subject to an observation period, which includes review clauses to identify and address any unintended consequences.

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

* unaudited

Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued
Funding sources
The table below shows the Group's primary funding sources including deposits in disposal groups and excluding repurchase agreements.

	2011		2010		2009	
	£m	%	£m	%	£m	%
Deposits by banks						
- central banks	3,680	0.5	6,655	0.9	8,535	1.0
- derivative cash collateral	31,807	4.6	28,074	3.8	32,552	4.0
- other	33,627	4.8	31,588	4.3	75,173	9.2
	69,114	9.9	66,317	9.0	116,260	14.2
Debt securities in issue						
- conduit asset backed commercial paper (ABCP)	11,164	1.6	17,320	2.3	25,583	3.1
- other commercial paper (CP)	5,310	0.8	8,915	1.2	18,724	2.3
- certificates of deposit (CDs)	16,367	2.4	37,855	5.1	58,195	7.1
- medium-term notes (MTNs)	105,709	15.2	131,026	17.6	125,800	15.4
- covered bonds	9,107	1.3	4,100	0.6	—	—
- securitisations	14,964	2.1	19,156	2.6	18,027	2.2
	162,621	23.4	218,372	29.4	246,329	30.1
Subordinated liabilities	26,319	3.8	27,053	3.6	31,538	3.9
Notes issued	188,940	27.2	245,425	33.0	277,867	34.0
Wholesale funding	258,054	37.1	311,742	42.0	394,127	48.2
Customer deposits						
- cash collateral	9,242	1.4	10,433	1.4	9,934	1.2
- other	427,511	61.5	420,433	56.6	413,224	50.6
Total customer deposits	436,753	62.9	430,866	58.0	423,158	51.8
Total funding	694,807	100.0	742,608	100.0	817,285	100.0
Disposal group deposits included above						
- banks	1		266		618	
- customers	22,610		2,267		8,907	
	22,611		2,533		9,525	

	2011	2010	2009
Short-term wholesale funding	£bn	£bn	£bn
Deposits	32.9	34.7	77.3
Notes issued	69.5	95.0	139.0
STWF excluding derivative collateral	102.4	129.7	216.3
Derivative collateral	31.8	28.1	32.6
STWF including derivative collateral	134.2	157.8	248.9
Interbank funding excluding derivative collateral			
- bank deposits	37.3	38.2	83.7

- bank loans	(24.3)	(31.3)	(31.3)
Net interbank funding	13.0	6.9	52.4

Key points

- Short-term wholesale funding excluding derivative collateral declined £27.3 billion in 2011, from £129.7 billion to £102.4 billion. This is £52.9 billion lower than the Group's liquidity portfolio. Deleveraging in Non-Core and Markets has led to the reduced need for funding.

- The Group's customer deposits excluding cash collateral grew by approximately £7.1 billion in 2011.

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

	Debt securities in issue								
	Conduit ABCP	Other CP and CDs	MTNs	Covered bonds	Securitisations	Total	Subordinated liabilities	Total notes issued	Total notes issued
2011	£m	£m	£m	£m	£m	£m	£m	£m	%
Less than 1 year	11,164	21,396	36,302	—	27	68,889	624	69,513	36.8
1-3 years	—	278	26,595	2,760	479	30,112	3,338	33,450	17.7
3-5 years	—	2	16,627	3,673	—	20,302	7,232	27,534	14.6
More than 5 years	—	1	26,185	2,674	14,458	43,318	15,125	58,443	30.9
	11,164	21,677	105,709	9,107	14,964	162,621	26,319	188,940	100.0
2010									
Less than 1 year	17,320	46,051	30,589	—	88	94,048	964	95,012	38.7
1-3 years	—	702	47,357	1,078	12	49,149	754	49,903	20.3
3-5 years	—	12	21,466	1,294	34	22,806	8,476	31,282	12.8
More than 5 years	—	5	31,614	1,728	19,022	52,369	16,859	69,228	28.2
	17,320	46,770	131,026	4,100	19,156	218,372	27,053	245,425	100.0
2009									
Less than 1 year	25,583	76,008	33,696	—	1,614	136,901	2,144	139,045	50.0
1-5 years	—	895	69,400	—	142	70,437	4,235	74,672	26.9
More than 5 years	—	16	22,704	—	16,271	38,991	25,159	64,150	23.1
	25,583	76,919	125,800	—	18,027	246,329	31,538	277,867	100.0

Key point

- Debt securities in issue with a maturity of less than one year declined £25.1 billion from £94.0 billion at 31 December 2010 to £68.9 billion at 31 December 2011, largely due to the maturity of £20.1 billion of notes issued under the UK Government's Credit Guarantee Scheme (CGS). The remaining notes issued under the CGS are due to mature in 2012, £15.6 billion in the first quarter of the year and £5.7 billion in the second quarter.

Short-term borrowings*

Short-term borrowings comprise repurchase agreements, borrowings from financial institutions, commercial paper and certificates of deposit. Derivative collateral received from financial institutions is excluded from the table below, as are certain long-term borrowings.

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

	Repurchase agreements	Financial institutions (1,2)	CP	CDs	2011 Total	Repurchase agreements	Financial institutions (1,2)	CP	CDs	2010 Total	2009 Total
At year end											
- balance (£bn)	129	93	16	16	254	115	92	26	38	271	242
- weighted average interest rate	0.6%	0.9%	0.9%	1.4%	0.8%	0.5%	0.6%	0.7%	0.6%	0.6%	0.8%

During the year

- maximum balance (£bn)	175	111	32	39	357	157	127	37	57	378	357
- average balance (£bn)	142	93	22	31	288	137	109	34	50	330	292
- weighted average interest rate	0.9%	1.1%	0.7%	1.2%	1.0%	0.6%	0.8%	0.9%	1.0%	0.7%	1.9%

Notes:
(1) Excludes derivative cash collateral of £41 billion at 31 December 2011 (2010 - £38 billion; 2009 - £33 billion), 2011 average of £35 billion (2010 - £34 billion; 2009 - £40 billion).
(2) Excludes Federal Home Loan Bank's long-term borrowings of £1 billion at 31 December 2011 (2010 - £1 billion), 2011 average of £1 billion (2010 - £1 billion).

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

* unaudited

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Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued

Long-term debt issuances

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

	2011 £m	2010 £m	2009 £m
Public			
- unsecured	5,085	12,887	8,386
- unsecured: guaranteed	—	—	19,663
- secured	9,807	8,041	—
Private			
- unsecured	12,414	17,450	14,895
- unsecured: guaranteed	—	—	15,459
- secured	500	—	—
Gross issuance	27,806	38,378	58,403
Buybacks	(6,892)	(6,298)	(7,264)
Net issuance	20,914	32,080	51,139

Key points

- In line with the Group's Strategic Plan, it has been an active issuer in recent years as it improved its liquidity and funding profile. Secured funding has increased as a proportion of total wholesale funding more recently as market dislocation and uncertainty over future regulatory developments have made unsecured markets less liquid.

- As the Group delevers, with Non-Core and Markets third party assets decreasing and Retail & Commercial deposits increasing, net term debt issuance decreased from £32 billion in 2010 to £21 billion in 2011. The net requirement in 2012 is not expected to exceed £10 billion as further deleveraging should cover the differences.*

- The Group undertakes voluntary buybacks of its privately issued debt in order to maintain client relationships and as part of its normal market making activities. These transactions are conducted at prevailing market rates.

The table below shows the original maturity of public long-term debt securities issued.

	1-3 years	3-5 years	5-10 years	>10 years	Total
2011	£m	£m	£m	£m	£m
MTNs	904	1,407	1,839	935	5,085
Covered bonds	—	1,721	3,280	—	5,001
Securitisations	—	—	—	4,806	4,806
	904	3,128	5,119	5,741	14,892
% of total	6	21	34	39	100
2010					
MTNs	1,445	2,150	6,559	2,733	12,887

Covered bonds	—	1,030	1,244	1,725	3,999
Securitisations	—	—	—	4,042	4,042
	1,445	3,180	7,803	8,500	20,928
% of total	7	15	37	41	100
2009					
MTNs	13,450	7,457	3,477	3,665	28,049
% of total	48	27	12	13	100

* unaudited

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The table below shows the currency breakdown of public and private long-term debt securities issued.

2011	GBP £m	EUR £m	USD £m	AUD £m	Other £m	Total £m
Public						
- MTNs	—	1,808	2,181	1,096	—	5,085
- covered bonds	—	5,001	—	—	—	5,001
- securitisations	478	1,478	2,850	—	—	4,806
Private	2,872	3,856	3,183	302	2,701	12,914
	3,350	12,143	8,214	1,398	2,701	27,806
% of total	12	44	29	5	10	100
2010						
Public						
- MTNs	1,260	3,969	5,131	1,236	1,291	12,887
- covered bonds	—	3,999	—	—	—	3,999
- securitisations	663	1,629	1,750	—	—	4,042
Private	2,184	10,041	2,879	174	2,172	17,450
	4,107	19,638	9,760	1,410	3,463	38,378
% of total	11	51	25	4	9	100
2009						
Public						
- MTNs	7,267	4,795	10,940	3,173	1,874	28,049
Private	4,932	9,773	9,668	2,738	3,243	30,354
	12,199	14,568	20,608	5,911	5,117	58,403
% of total	21	25	35	10	9	100

Key points

- In line with the Group's plan to diversify its funding mix, issuances were spread across G10 currencies and maturity bands, including £5.7 billion of public issuance with an original maturity of greater than 10 years.
- The Group has issued approximately £2.8 billion since year end, including a £1 billion public covered bond issuance and a US$1.2 billion securitisation.

Secured funding

The Group has access to secured funding markets through own-asset securitisation and covered bond funding programmes to complement existing wholesale funding programmes and access to the repo markets. The Group monitors and manages encumbrance levels related to these secured funding programmes. This includes the potential encumbrance of Group assets that could be used in own-asset securitisations and/or covered bonds that could be used as contingent liquidity.

For information on the Group's own-asset securitisations, covered bond programme and securities repurchase agreements, refer to Note 30 on the consolidated accounts on pages 355 and 356.

Liquidity management

Liquidity risk management requires ongoing assessment and calibration of: how the various sources of the Group's liquidity risk interact with each other; market dynamics; and regulatory developments to determine the overall size of the Group's liquid asset buffer. In addition to the size determination, the composition of the buffer is also important. The composition is reviewed on a continuous basis in order to ensure that the Group holds an appropriate portfolio of high quality assets that can provide a cushion against market disruption and dislocation, even in the most extreme stress circumstances.

Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued

Liquidity portfolio

The table below shows the composition of the Group's liquidity portfolio (at estimated liquidity value). All assets within the liquidity portfolio are unencumbered.

	2011		2010	2009
	Average	Period end	Period end	Period end
	£m	£m	£m	£m
Cash and balances at central banks	74,711	69,932	53,661	51,500
Treasury bills	5,937	—	14,529	30,010
Central and local government bonds (1)				
- AAA rated governments and US agencies	37,947	29,632	41,435	30,140
- AA- to AA+ rated governments (2)	3,074	14,102	3,744	2,011
- governments rated below AA	925	955	1,029	1,630
- local government	4,779	4,302	5,672	5,706
	46,725	48,991	51,880	39,487
Other assets (3)				
- AAA rated	21,973	25,202	17,836	20,246
- below AAA rated and other high quality assets	12,102	11,205	16,693	29,418
	34,075	36,407	34,529	49,664
Total liquidity portfolio	161,448	155,330	154,599	170,661

Notes:

(1) Includes FSA eligible government bonds of £36.7 billion at 31 December 2011 (2010 - £34.7 billion; 2009 - £19.9 billion).

(2) Includes AAA rated US government guaranteed and US government sponsored agencies. The US government was downgraded from AAA to AA+ by S&P on 5 August 2011, although not by Moody's or Fitch. These securities are reflected here.

(3) Includes assets eligible for discounting at central banks.

Key point

- In view of the continuing uncertain market conditions, the liquidity portfolio was maintained above the Group's target level of £150 billion at £155.3 billion, with an average balance in 2011 of £161.4 billion. In anticipation of challenging market conditions, the composition was altered to become more liquid and conservative, as cash and balances at central banks rose to 45% of the total portfolio at 31 December 2011, from 35% at 31 December 2010.

Liquidity and funding metrics

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

Loan to deposit ratio and funding gap

The table below shows the Group's loan:deposit ratio and customer funding gap, including disposal groups.

	Loan:deposit ratio		Customer
	Group	Core	

	%	%	funding gap Group £bn
2011	108	94	37
2010	118	96	77
2009	132	103	137

Note:
(1) Loans are net of provisions, excluding repos. For Group before RFS MI only for 2009.

Key points
- The Group's loan:deposit ratio improved 1,000 basis points to 108% during 2011, as loans declined and deposits grew.

- The customer funding gap almost halved with Non-Core contributing £27 billion of the £40 billion reduction.

Net stable funding ratio*
The table below shows the Group's net stable funding ratio (NSFR), estimated by applying the Basel III guidance issued in December 2010, which represents a non-GAAP measure as described on page 2. The Group is aiming to meet the minimum required NSFR of 100% over the longer term. This measure seeks to show the proportion of structural term assets which are funded by stable funding, including customer deposits, long-term wholesale funding and equity. One of the main components of the ratio entails categorising retail and SME deposits as either 'more stable' or 'less stable'. The Group's NSFR will also continue to be refined over time in line with regulatory developments. It may be calculated on a basis that is not consistent with that used by other financial institutions.

	2011		2010		2009		
		ASF(1)		ASF(1)		ASF(1)	Weighting
	£bn	£bn	£bn	£bn	£bn	£bn	%
Equity	76	76	77	77	80	80	100
Wholesale funding > 1 year	124	124	154	154	144	144	100
Wholesale funding < 1 year	134	—	157	—	250	—	—
Derivatives	524	—	424	—	422	—	—
Repurchase agreements	129	—	115	—	106	—	—
Deposits							
- Retail and SME - more stable	227	204	172	155	166	149	90
- Retail and SME - less stable	31	25	51	41	50	40	80
- Other	179	89	206	103	199	99	50
Other (2)	83	—	98	—	105	—	—
Total liabilities and equity	1,507	518	1,454	530	1,522	512	
Cash	79	—	57	—	52	—	—
Inter-bank lending	44	—	58	—	49	—	—
Debt securities > 1 year							
- central and local governments AAA to AA-	77	4	89	4	84	4	5
- other eligible bonds	73	15	75	15	87	17	20
- other bonds	14	14	10	10	9	9	100
Debt securities < 1 year	45	—	43	—	69	—	—
Derivatives	530	—	427	—	438	—	—
Reverse repurchase agreements	101	—	95	—	76	—	—
Customer loans and advances > 1 year							
- residential mortgages	145	94	145	94	137	89	65
- other	173	173	211	211	241	241	100
Customer loans and advances < 1 year							
- retail loans	19	16	22	19	24	20	85
- other	137	69	125	63	153	77	50
Other (3)	70	70	97	97	103	103	100
Total assets	1,507	455	1,454	513	1,522	560	
Undrawn commitments	240	12	267	13	289	14	5
Total assets and undrawn commitments	1,747	467	1,721	526	1,811	574	
Net stable funding ratio		111%		101%		89%	

Notes:
(1) Available stable funding.
(2) Deferred tax, insurance liabilities and other liabilities.

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

Key points*

- The NSFR increased by 10% in the year to 111%, with the funding cushion over term assets and undrawn commitments increasing from £4 billion to £51 billion.

- Available stable funding decreased by £12 billion in the year as a result of a £30 billion reduction in long-term wholesale funding, including the move into short-term of approximately £20 billion of balances under the CGS. This was offset by a £19 billion increase in qualifying deposit balances, including classification of certain deposits as more stable, as some assumptions and methodologies were refined.

- Term assets decreased in the year by £38 billion primarily reflecting Non-Core disposals and run-offs. The decrease in other assets is primarily due to the closure of certain equities businesses in Markets and other asset movements.

* unaudited

Balance sheet management: Liquidity and funding risk continued

Special purpose entities

The Group arranges securitisations to facilitate client transactions and undertakes securitisations to sell financial assets or to fund specific portfolios of assets. The Group also acts as an underwriter and depositor in securitisation transactions involving both client and proprietary transactions. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity (SPE) which then issues liabilities to third party investors. SPEs are vehicles established for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms - trusts, partnerships and companies - and fulfil many different functions. As well as being a key element of securitisations, SPEs are also used in fund management activities to segregate custodial duties from the fund management advice provided by the Group.

The Group applies the guidance in IAS 27 ‘Consolidated and Separate Financial Statements’ and SIC 12 ‘Consolidation - Special Purpose Entities’ in determining whether or not to consolidate an SPE. SPEs are consolidated where the substance of the relationship between the Group and the SPE is such that the SPE is controlled by the Group. In determining whether the SPE is controlled by the Group, the Group considers whether the activities of the SPE are being conducted on its behalf so that it obtains benefits from its operation; whether the Group has the decision-making powers to obtain the majority of the benefits of the SPE’s activities; whether the Group has rights to obtain the majority of the benefits of the SPE; and whether the Group retains the majority of the residual or ownership risks related to the SPE or its assets so as to obtain benefits from its activities. As a result of applying these principles, the Group does not consolidate those SPEs where its interests in the SPE do not provide the Group with a majority of the benefits and/or residual or ownership risks and therefore the SPE is not controlled by the Group. SPEs that are in substance controlled by the Group are consolidated. The Group accounts for its interests, for example, holdings of securities issued and liquidity commitments, in SPEs it does not consolidate in accordance with its accounting policy for these items.

The Group sponsors and arranges own-asset securitisations, whereby the sale of assets or interests in a pool of assets into an SPE is financed by the issuance of securities to investors. The pool of assets held by the SPE may be originated by the Group, or (in the case of whole loan programmes) purchased from third parties, and may be of varying credit quality. Investors in the debt securities issued by the SPE are rewarded through credit-linked returns, according to the credit rating of their securities. The majority of securitisations are supported through liquidity facilities, other credit enhancements and derivative hedges extended by financial institutions, some of which offer protection against initial defaults in the pool of assets. Thereafter, losses are absorbed by investors in the lowest ranking notes in the priority of payments. Investors in the most senior ranking debt securities are typically shielded from loss, since any subsequent losses may trigger repayment of their initial principal.

The Group also employs synthetic structures, where assets are not sold to the SPE, but credit derivatives are used to transfer the credit risk of the assets to an SPE. Securities may then be issued by the SPE to investors, on the back of the credit protection sold to the Group by the SPE.

Residential and commercial mortgages and credit card receivables form the types of assets generally included in cash securitisations, while corporate loans and commercial mortgages typically serve as reference obligations in synthetic securitisations.

The Group sponsors own-asset securitisations primarily as a way of diversifying funding sources. The Group purchases the securities issued in own-asset securitisations and may pledge as collateral for repurchase agreements with major central banks.

Refer to Note 30 on the consolidated accounts on page 355 for the asset categories, together with the carrying value of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (refer to page 83), where the assets continue to be recorded on the Group's balance sheet.

Conduits

The Group sponsors and administers a number of asset-backed commercial paper (ABCP) conduits. A conduit is a SPE that issues commercial paper and uses the proceeds to purchase or fund a pool of assets. The commercial paper is secured on the assets and is redeemed by further commercial paper issuance, repayment of assets or funding from liquidity facilities. Commercial paper is typically short-dated, usually up to three months.

Group-sponsored conduits can be divided into multi-seller conduits and own-asset conduits. In determining whether or not to consolidate a conduit the Group applies the same criteria as to SPEs. Liquidity commitments from the Group to the conduit exceed the nominal amount of assets funded by the conduit as liquidity commitments are sized to cover the funding cost of the related assets.

The ways the Group may be involved with conduits and other special purpose entities are described on page 82.

The Group's involvement in conduits takes a number of forms. It may:

- Sponsor an ABCP programme i.e. establish the programme and approve the sellers permitted to participate in the programme and the asset pools to be purchased by the programme;
- Administer an ABCP programme;
- Provide the ABCP conduit with liquidity facilities;
- Provide the ABCP conduit with a programme-wide credit enhancement facility; or
- Purchase commercial paper from an ABCP conduit.

Total assets and other aspects relating to the Group's conduits are set out below.

	2011			2010			2009		
	Core	Non-Core	Total	Core	Non-Core	Total	Core	Non-Core	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Total assets held by the conduits	11,208	1,893	13,101	16,390	3,624	20,014	23,409	3,957	27,366
Commercial paper issued (1)	10,590	859	11,449	15,522	2,540	18,062	22,644	2,939	25,583
Liquidity and credit enhancements									
Deal specific liquidity									
- drawn	321	1,051	1,372	868	1,109	1,977	738	1,059	1,797
- undrawn	15,324	1,144	16,468	21,935	2,980	24,915	28,628	3,852	32,480
PWCE (2)	795	193	988	1,025	257	1,282	1,167	341	1,508
	16,440	2,388	18,828	23,828	4,346	28,174	30,533	5,252	35,785
Maximum exposure to loss (3)	15,646	2,194	17,840	22,803	4,089	26,892	29,365	4,911	34,276

Notes:

(1) Includes £0.3 billion of ABCP issued to RBS plc at 31 December 2011 (2010 - £0.7 billion).

(2) Programme-wide credit enhancement (PWCE) is an additional programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

(3)

Maximum exposure to loss quantifies the Group's exposure to its sponsored conduits. It is determined as the Group's liquidity commitment to its sponsored conduits and additional PWCE which would absorb first loss on transactions where liquidity support is provided by third parties. Historically, PWCE has been greater than third party liquidity. Therefore the maximum exposure to loss is total deal specific liquidity.

(4) Liquidity commitments from the Group to the conduit exceed the nominal amount of assets funded by the conduit given that liquidity commitments are sized to cover the accrued funding cost of the related assets.

Key points

- During 2011, both multi-seller and own-asset conduit assets decreased, as deals terminated and Non-Core assets were sold. The total assets held by Group-sponsored conduits were £13.1 billion at 31 December 2011 (2010 - £20.0 billion; 2009 - £27.4 billion).

- The average maturity of ABCP issued by the Group's conduits at 31 December 2011 was 42.6 days (2010 - 69.4 days; 2009 - 58.4 days).

- The maturity of the commercial paper issued by the Group's conduits is managed to mitigate the short-term contingent liquidity risk of providing back-up facilities. The Group's limits sanctioned for such liquidity facilities in 2011 totalled approximately £16.8 billion for multi-seller conduits (2010 - £22.6 billion; 2009 - £25.0 billion).

- The weighted average life of the funded assets was 1.9 years at 31 December 2011 (2010 - 2.3 years; 2009 - 1.9 years).

- The Group's maximum exposure to loss on its multi-seller conduits is £16.7 billion (2010 - £22.8 billion; 2009 - £25.2 billion), being the total amount of the Group's liquidity commitments plus the extent of the programme-wide credit enhancement of conduit assets for which facilities were not provided by third parties.

- The Group holds a single own-asset conduit, which has assets funded by the Group. The Group's maximum exposure to loss on own-asset conduits was £1.1 billion in 2011 (2010 - £4.1 billion; 2009 - £9.1 billion), with no ABCP outstanding at that date (2010 - £2.2 billion; 2009 - £7.7 billion).

- Multi-seller conduits accounted for 93% of the total liquidity and credit enhancements committed by the Group at 31 December 2011 (2010 - 84%; 2009 - 73%). The Group's multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance.

Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued

Conduits continued

The Group has not utilised its own-asset conduit with a committed liquidity of £26 billion (2010 - £26 billion) to access the Bank of England's open market operations for contingent funding purposes. This conduit is not included above, or in the tables on pages 84 and 85.

Collateral analysis, profile, credit ratings and weighted average lives relating to the Group's consolidated conduits are detailed below.

	Funded assets			Undrawn	Liquidity	
				commitments	from third	Total
	Loans	Securities	Total	to fund assets	parties	exposure
2011	£m	£m	£m	£m	£m	£m
Auto loans	3,663	390	4,053	2,241	—	6,294
Corporate loans	146	72	218	16	—	234
Credit card receivables	865	—	865	699	—	1,564
Trade receivables	1,136	126	1,262	649	—	1,911
Student loans	488	—	488	352	—	840
Consumer loans	1,362	—	1,362	101	—	1,463
Mortgages						
- prime	2,239	—	2,239	308	—	2,547
- non-conforming	727	—	727	34	—	761
- commercial	21	489	510	8	—	518
Other	760	617	1,377	331	—	1,708
	11,407	1,694	13,101	4,739	—	17,840
2010						
Auto loans	4,943	346	5,289	2,964	—	8,253
Corporate loans	115	2,340	2,455	106	—	2,561
Credit card receivables	2,088	—	2,088	1,209	—	3,297
Trade receivables	761	—	761	1,090	—	1,851
Student loans	757	—	757	532	(132)	1,157
Consumer loans	1,889	—	1,889	111	—	2,000
Mortgages						
- prime	2,569	3	2,572	752	—	3,324
- non-conforming	1,371	—	1,371	20	—	1,391
- sub-prime	103	—	103	19	—	122
- commercial	210	450	660	76	(21)	715
Other	1,072	997	2,069	(1)	(10)	2,058
	15,878	4,136	20,014	6,878	(163)	26,729
2009						
Auto loans	4,293	356	4,649	2,526	—	7,175
Corporate loans	106	7,695	7,801	161	—	7,962
Credit card receivables	4,083	—	4,083	1,058	—	5,141
Trade receivables	806	—	806	1,351	—	2,157

Student loans	915	—	915	263	(132)	1,046
Consumer loans	1,686	—	1,686	222	—	1,908
Mortgages						
- prime	2,739	3	2,742	750	—	3,492
- non-conforming	1,548	—	1,548	193	—	1,741
- commercial	413	458	871	155	(22)	1,004
Other	872	1,393	2,265	232	(12)	2,485
	17,461	9,905	27,366	6,911	(166)	34,111

	CP funded assets									
						Credit ratings (S&P equivalent)				
	UK	Europe	US	RoW	Total	AAA	AA	A	BBB	Below BBB
2011	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Auto loans	518	1,145	2,141	249	4,053	3,323	683	40	7	—
Corporate loans	—	160	58	—	218	9	94	27	88	—
Credit card receivables	—	—	865	—	865	774	—	91	—	—
Trade receivables	—	567	695	—	1,262	449	343	426	44	—
Student loans	—	—	488	—	488	488	—	—	—	—
Consumer loans	716	—	646	—	1,362	—	—	1,362	—	—
Mortgages										
- prime	182	—	—	2,057	2,239	1,446	737	39	17	—
- non-conforming	667	60	—	—	727	157	265	287	18	—
- commercial	489	—	—	21	510	2	5	498	5	—
Other	124	201	531	521	1,377	363	42	402	180	390
	2,696	2,133	5,424	2,848	13,101	7,011	2,169	3,172	359	390
2010										
Auto loans	429	962	3,434	464	5,289	4,827	354	101	7	—
Corporate loans	22	1,513	709	211	2,455	2,166	161	128	—	—
Credit card receivables	144	—	1,944	—	2,088	1,912	125	—	51	—
Trade receivables	—	261	500	—	761	265	353	95	48	—
Student loans	116	—	641	—	757	641	116	—	—	—
Consumer loans	766	462	661	—	1,889	16	—	1,873	—	—
Mortgages										—
- prime	161	—	—	2,411	2,572	1,043	1,476	32	21	—
- non-conforming	712	659	—	—	1,371	782	273	316	—	—
- sub-prime	103	—	—	—	103	—	68	—	35	—
- commercial	627	—	—	33	660	16	5	635	4	—
Other	447	455	353	814	2,069	95	52	1,242	680	—
	3,527	4,312	8,242	3,933	20,014	11,763	2,983	4,422	846	—
2009										
Auto loans	476	982	2,621	570	4,649	2,965	1,547	137	—	—
Corporate loans	312	5,213	1,411	865	7,801	7,584	111	106	—	—
Credit card receivables	177	—	3,823	83	4,083	2,781	759	420	123	—
Trade receivables	—	334	438	34	806	446	266	60	34	—
Student loans	117	—	798	—	915	798	117	—	—	—
Consumer loans	733	800	153	—	1,686	68	50	1,553	15	—
Mortgages										
- prime	138	—	—	2,604	2,742	949	1,746	28	3	16
- non-conforming	599	949	—	—	1,548	1,070	379	99	—	—
- commercial	641	194	—	36	871	25	3	840	—	3
Other	121	670	298	1,176	2,265	170	249	950	896	—
	3,314	9,142	9,542	5,368	27,366	16,856	5,227	4,193	1,071	19

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Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued

Assets and liabilities by contractual cash flow maturity

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

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

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

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

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

2011	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	79,269	—	—	—	—	—
Loans and advances to banks	26,326	1,294	544	121	114	—
Debt securities	7,237	9,569	23,137	21,003	39,148	15,869
Settlement balances	7,759	8	—	1	—	—
Other financial assets	397	158	—	16	738	—
Total maturing assets	120,988	11,029	23,681	21,141	40,000	15,869
Loans and advances to customers	97,318	90,894	108,331	55,785	62,085	56,259
Derivatives held for hedging	519	1,556	3,438	1,695	596	138
	218,825	103,479	135,450	78,621	102,681	72,266

Liabilities by contractual maturity						
Deposits by banks	39,139	5,104	5,513	461	1,121	364
Debt securities in issue	66,253	15,756	25,099	17,627	18,833	4,190
Subordinated liabilities	133	1,116	4,392	7,872	8,654	3,488
Settlement balances and other liabilities	9,015	37	36	62	16	15
Total maturing liabilities	114,540	22,013	35,040	26,022	28,624	8,057
Customer accounts	379,692	23,068	12,643	5,389	1,483	779
Derivatives held for hedging	525	788	1,981	1,186	1,101	821
	494,757	45,869	49,664	32,597	31,208	9,657
Maturity gap	6,448	(10,984)	(11,359)	(4,881)	11,376	7,812
Cumulative maturity gap	6,448	(4,536)	(15,895)	(20,776)	(9,400)	(1,588)
Guarantees and commitments notional amount						
Guarantees (1)	24,886	—	—	—	—	—
Commitments (2)	239,963	—	—	—	—	—

For notes relating to this table refer to page 88.

2010	0-3 months £m	3-12 months £m	1-3 years £m	3-5 years £m	5-10 years £m	10-20 years £m
Assets by contractual maturity						
Cash and balances at central banks	56,988	—	—	1	—	25
Loans and advances to banks	33,809	1,377	711	120	193	79
Debt securities	11,247	9,816	25,059	22,400	40,600	22,128
Settlement balances	11,334	231	—	—	41	—
Other financial assets	458	221	207	15	405	—
Total maturing assets	113,836	11,645	25,977	22,536	41,239	22,232
Loans and advances to customers	112,465	86,592	120,139	69,304	78,131	63,015
Derivatives held for hedging	530	1,588	2,612	638	210	101
	226,831	99,825	148,728	92,478	119,580	85,348
Liabilities by contractual maturity						
Deposits by banks	43,396	4,417	1,243	304	651	374
Debt securities in issue	89,583	43,032	31,862	22,569	24,209	6,697
Subordinated liabilities	2,485	2,611	6,570	8,691	8,672	4,607
Settlement balances and other liabilities	12,423	59	136	177	385	25
Total maturing liabilities	147,887	50,119	39,811	31,741	33,917	11,703
Customer accounts	402,457	18,580	8,360	4,651	4,393	2,384
Derivatives held for hedging	608	936	2,103	969	681	253
	550,952	69,635	50,274	37,361	38,991	14,340
Maturity gap	(34,051)	(38,474)	(13,834)	(9,205)	7,322	10,529
Cumulative maturity gap	(34,051)	(72,525)	(86,359)	(95,564)	(88,242)	(77,713)
Guarantees and commitments notional amount						
Guarantees (1)	31,026	—	—	—	—	—
Commitments (2)	266,822	—	—	—	—	—

For notes relating to this table refer to page 88.

Business review Risk and balance sheet management continued

Balance sheet management: Liquidity and funding risk continued
Assets and liabilities by contractual cash flow maturity continued

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

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

Held-for-trading assets of £763 billion and liabilities of £708 billion (2010 - £665 billion assets, £586 billion liabilities; 2009 - £651 billion assets, £568 billion liabilities) have been excluded from the table in view of their short-term nature.

Interest rate risk

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

The Group provides financial products to satisfy a variety of customer requirements. Loans and deposits are designed to meet customer objectives with regard to repricing frequency, tenor, index, prepayment, optionality and other features. When aggregated, they form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates.

However, mismatches in these sensitivities give rise to net interest income (NII) volatility as interest rates rise and fall. For example, a bank with a floating rate loan portfolio and largely fixed rate deposits will see its NII rise as interest rates rise and fall as rates decline. Due to the long-term nature of many banking book portfolios, varied interest rate repricing characteristics and maturities, it is likely the NII will vary from period to period, even if interest rates remain the same. New business volumes originated in any period will alter the interest rate sensitivity of a bank if the resulting portfolio differs from portfolios originated in prior periods.

The Group assesses interest rate risk in the banking book (IRRBB) using a set of standards to define, measure and report the market risk. It is the Group’s policy to minimise interest rate sensitivity in banking book portfolios and where interest rate risk is retained, to ensure that appropriate measures and limits are applied. Key measures used to evaluate IRRBB are subjected to approval of divisional Asset and Liability Management Committees (ALCOs) and the Group Asset and Liability Management Committee (GALCO).

Limits on IRRBB are proposed by the Group Treasurer for approval by the Executive Risk Forum annually.

The Group uses a variety of approaches to quantify its interest rate risk. IRRBB is measured using a version of the same value-at-risk (VaR) methodology that is used for the Group’s trading portfolios. Net interest income exposures are measured in terms of sensitivity over time to movements in interest rates. Additionally, Citizens measures the sensitivity of the market value of equity to changes in forward interest rates.

With the exception of Citizens and Markets, divisions are required to manage IRRBB through internal transactions with Group Treasury, to the greatest extent possible. Residual risks in divisions must be measured and reported as described below.

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

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

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

	Average	Period end	Maximum	Minimum
	£m	£m	£m	£m
2011	63	51	80	44
2010	58	96	96	30
2009	86	101	123	53

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

Currency	2011 £m	2010 £m	2009 £m
Euro	26	33	32
Sterling	57	79	111
US dollar	61	121	42
Other	5	10	9

Key points

- Interest rate exposure at 31 December 2011 was considerably lower than at 31 December 2010 but average exposure was 9% higher in 2011 than in 2010.

- The reduction in US dollar VaR reflects, in part, changes in holding period assumptions following changes in Non-Core assets.*

* unaudited

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Balance sheet management: Interest rate risk continued

Sensitivity of net interest income*

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

The following table shows the sensitivity of NII, over the next twelve months, to an immediate upward or downward change of 100 basis points to all interest rates. In addition, the table includes the impact of a gradual 400 basis point steepening and a gradual 300 basis point flattening of the yield curve at tenors greater than a year. This scenario differs from that applied in the previous year in both the severity of the rate shift and the tenors to which this is applied.

	2011	2010	2009
Potential favourable/(adverse) impact on NII	£m	£m	£m
+ 100 basis points shift in yield curves	244	232	510
– 100 basis points shift in yield curves	(183)	(352)	(687)
Bear steepener	443		
Bull flattener	(146)		

Key points*

- The Group's interest rate exposure remains slightly asset sensitive, driven in part by changes to underlying business assumptions as rates rise. The impact of the steepening and flattening scenarios is largely driven by the investment of net free reserves.

- The reported sensitivity will vary over time due to a number of factors such as market conditions and strategic changes to the balance sheet mix and should not therefore be considered predictive of future performance.

* unaudited

Structural foreign currency exposures

Structural foreign exchange exposures represent net investment in subsidiaries, associates and branches, the functional currencies of which are currencies other than sterling. The Group hedges structural foreign currency exposures only in limited circumstances. The Group's objective is to ensure, where practical, that its consolidated capital ratios are largely protected from the effect of changes in exchange rates. The Group seeks to limit the sensitivity to its Core Tier 1 ratio to 20 basis points in a 10% rate shock scenario. The Group's structural foreign currency position is reviewed by GALCO regularly.

The table below shows the Group's structural foreign currency exposures.

2011	Net assets of overseas operations £m	RFS MI £m	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures pre-economic hedges £m	Economic hedges (1) £m	Residual structural foreign currency exposures £m
US dollar	17,570	1	17,569	(2,049)	15,520	(4,071)	11,449
Euro	8,428	(3)	8,431	(621)	7,810	(2,236)	5,574
Other non-sterling	5,224	272	4,952	(4,100)	852	—	852
	31,222	270	30,952	(6,770)	24,182	(6,307)	17,875
2010							
US dollar	17,137	2	17,135	(1,820)	15,315	(4,058)	11,257
Euro	8,443	33	8,410	(578)	7,832	(2,305)	5,527
Other non-sterling	5,320	244	5,076	(4,135)	941	—	941
	30,900	279	30,621	(6,533)	24,088	(6,363)	17,725
2009							
US dollar	15,589	(2)	15,591	(3,846)	11,745	(5,696)	6,049
Euro	21,900	13,938	7,962	(2,351)	5,611	(3,522)	2,089
Other non-sterling	5,706	511	5,195	(4,001)	1,194	—	1,194
	43,195	14,447	28,748	(10,198)	18,550	(9,218)	9,332

Note:

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

Key points

- The Group's structural foreign currency exposure at 31 December 2011 was £24.2 billion and £17.9 billion before and after economic hedges respectively, broadly unchanged from the end of 2010 position.

- 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 £1.27 billion (2010 - £1.27 billion; 2009 - £0.98 billion) in equity, while a 5% weakening would result in a loss of £1.15 billion (2010 - £1.15 billion; 2009 - £0.88 billion) in equity.

Equity risk

The Group holds equity positions in the banking book in order to achieve strategic objectives, such as membership of an exchange or clearing house, or to support venture capital transactions or customer restructuring arrangements. The

Group is exposed to market risk on these banking book equity positions because they are measured at fair value. Fair values are based on available market prices where possible. In the event that market prices are not available, fair value is based on appropriate valuation techniques or management estimates.

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

	Listed	Unlisted	Total
2011	£m	£m	£m
Group	576	1,768	2,344
2010			
Group	535	2,080	2,615
2009			
Group before RFS Holdings minority interest	401	2,388	2,789
RFS Holdings minority interest	60	211	271
Group	461	2,599	3,060

Note:

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

Risk management

Introduction

This section focuses on each of the key types of risk that RBS Group faces - explaining how the Group manages these risks and highlighting the enhancements made as a result of progress under the Group's ongoing initiatives to strengthen its approach to risk management.

Credit risk

All the disclosures in this section (pages 92 to 118) are audited unless otherwise indicated by an asterisk (*).

Credit risk is the risk of financial loss owing to the failure of a customer to meet its obligation to settle outstanding amounts. The quantum and nature of credit risk assumed across the Group's different businesses vary considerably, while the overall credit risk outcome usually exhibits a high degree of correlation with the macroeconomic environment.

Organisation

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

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

GCR is additionally responsible for verifying compliance by the divisions with all Group credit policies.

In the final quarter of 2011, the Executive Risk Forum (ERF) approved a change to the management of the credit portfolio, delegating greater authority to the Group Chief Credit Officer as chair of the functional credit committees that analyse and recommend the limits to the ERF. With effect from October 2011, the Group Chief Credit Officer chairs a single Credit Risk Committee, with the authority to approve limits for the majority of portfolios across the Group. The ERF retains its strategic role as the most senior risk committee outside the Group Board and will continue to approve material portfolio concentrations and higher risk portfolios such as commercial real estate. This change strengthens individual accountability across the risk organisation and encourages the engagement of business leaders in first line of defence risk activity.

Risk appetite

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

Throughout 2011, GCR's emphasis was on embedding the new risk management frameworks introduced in 2009 and 2010 and on ensuring alignment with the strategic risk objectives being pursued across the Group. Risk appetite has been expressed by the Group Board by reference to earnings volatility and stable capital and these principles underpin the frameworks that GCR has established, and is continuing to refine, to manage the Group's concentration risks in the Core balance sheet, by product/asset class, sector, single name and country.

In the two years since the new concentration framework was rolled out across the Group, the ERF has reviewed all material industry and product portfolios and agreed a risk appetite commensurate with the franchises represented in these reviews. In particular, limits have been reviewed and re-sized, to refine the Group's risk appetite in areas where it faces significant balance sheet concentrations or franchise challenges. The product/asset class, sector, single name and country limits are now firmly embedded in the risk management processes of the Group and form a pivotal part of the Risk function's engagement with the businesses on the appropriateness of risk appetite choices.

The new sector and asset class limits have been informed by the work undertaken to stress the portfolios and historical loss experience. In addition, they factor in the future consequences for risk and return in asset classes likely to be affected by the introduction of new regulatory capital rules under Basel III.

Product/asset class concentration framework

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

- Wholesale - formal policies, specialised tools and expertise, tailored monitoring and reporting and, in certain cases, specific limits and thresholds are deployed to address certain lines of business across the Group, where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. For example, in response to volatile conditions in the syndicated loan, fixed income and equities markets during 2011, the Group engaged in only selective underwriting activity in these markets. In addition to the limit structures the Group has in place to manage its overall exposure to underwriting activity, market-linked controls were introduced in the loan underwriting book in 2011, to align the risk profile more closely to asset price movements. Those portfolios identified as potentially representing a concentration or heightened risk are subject to formal governance, including periodic review, at either Group or divisional level, depending on materiality.

Sector concentration framework

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

As a result of the reviews carried out in 2011, the Group has reduced its risk appetite in the higher-risk sectors of leisure, media, commercial real estate, construction, automotive, and airlines and aerospace.

In response to the severe budgetary cuts mandated by the UK Government in 2010, the UK and Northern Ireland teams conducted a full review of the likely impact of the austerity measures on their corporate and retail lending portfolios. Areas of specific focus, such as local authority lending, where budgetary pressures will be hard felt, and portfolios exposed to discretionary consumer spend, such as the retail and leisure industries, were stressed using downside assumptions on further house price deterioration and higher unemployment. The output of these activities was reviewed by the Executive Risk Forum and actions agreed in the event that these scenarios threaten to materialise.

The impact of the eurozone crisis has been felt most significantly in the financial institutions sector, where widening credit spreads and regulatory demand for increases in Tier 1 capital have exacerbated the risk management challenges already posed by the sector's continued weakness, as provisions and write-downs remain elevated. A material percentage of global banking activity in risk mitigation now passes through the balance sheets of the top global players, increasing the systemic risks to the sector. The Group's exposures to these banks continue to be closely managed. The increased use of central clearing houses to reduce counterparty credit risk, including settlement risk, among the larger banks is a welcome move but one that will bring its own challenges. The weaker banks in the eurozone have also been the subject of heightened scrutiny and the Group's risk appetite for these banks was adjusted continuously throughout 2011.

Single name concentration framework*

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

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

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

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

* unaudited

Risk management: Credit risk continued
Risk appetite continued
Since 2009, the Group has been managing its corporate exposures to reduce concentrations and align its appetite for future business to the Group's broader strategies for its large corporate franchises. In the last quarter of 2011, the Group announced further refinements to the single name exposure management controls already in place, which brings them more closely in line with market best practice and which allows the Group to differentiate more consistently between the different risk types. These changes are expected to be implemented during the first quarter of 2012. The Group is continually reviewing its single name concentration framework to ensure that it remains appropriate for current economic conditions and in line with improvements in the Group's risk measurement models.

Reducing the risk arising from concentrations to single names remains a key focus of management attention. Continued progress was made in 2011 and credit exposures in excess of single name concentration limits were reduced by over 15% during the year. The challenges posed by continued market illiquidity and the impact of negative credit migration caused by the current economic environment are expected to continue throughout 2012.

Country
For information on how the Group manages credit risk by country, refer to the Country risk section on page 166.

Controls and assurance*
A strong independent assurance function is an important element of a sound control environment. During 2011, the Group took the decision to strengthen its credit quality assurance (CQA) activities and moved all divisional CQA resources under the centralised management of Group Credit Risk. The benefits of this action are already apparent in greater consistency of standards and cross utilisation of resources. Reviews planned for 2012 will benefit from the availability of subject matter experts across all material products and classes and an improved ability to track control breaches and strengthen processes.

Work began in the second half of 2011 on a major revision of the Group's key credit policies. This will ensure that the Group's control environment is appropriately aligned to the risk appetite that the Group Board has approved and provide a sound basis for the Group's independent audit and assurance activities across the credit risk function. The work is expected to be concluded by the end of the second quarter of 2012.

The Group Credit Risk function launched an assurance process to provide the Group Chief Credit Officer with additional evidence of the effectiveness of the controls in place across the Group to manage risk. The results of these reviews will be provided to the Executive Risk Forum and to the Board Risk Committee on a regular basis in support of the self-certification that Group Credit Risk is obliged to complete under the Group Policy Framework (refer to Operational risk on page 194 to 197).

Problem debt management
The Group's procedures for managing problem debts differ between wholesale and retail customers, as discussed below.

Wholesale customers
The controls and processes for managing wholesale problem debts are embedded within the divisions' credit approval frameworks and form an essential part of the ongoing credit assessment of customers. Any necessary approvals will be required in accordance with the delegated authority grid governing the extension of credit.

Early problem recognition

Each division has established Early Warning Indicators (EWIs) designed to identify those performing exposures that require close attention due to financial stress or heightened operational issues. Such identification may also take place as part of the annual review cycle. EWIs vary from division to division and comprise both internal parameters (e.g. account level information) and external parameters (e.g. the share price of publicly listed customers).

Customers identified through either the EWIs or annual review are reviewed by portfolio management and/or credit officers within the division, who determine whether or not the customer’s circumstances warrant placing the exposure on the Watchlist process (detailed below).

Watchlist process*

There are three Watchlist ratings - amber, red and black - reflecting progressively deteriorating conditions. Watchlist Amber loans are performing loans where the counterparty or sector shows early signs of potential stress or has other characteristics such that they warrant closer monitoring. Watchlist Red loans are performing loans where indications of the borrower’s declining creditworthiness are such that the exposure requires active management, usually by the Global Restructuring Group (GRG). Watchlist Black loans comprise risk elements in lending and potential problem loans.

Once on the Watchlist process, customers come under heightened scrutiny. The relationship strategy is reassessed by a forum of experienced credit, portfolio management and remedial management professionals within the division. In accordance with Group-wide policies, a number of mandatory actions will be taken, including a review of the customer’s credit grade and facility 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, an imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

For all Watchlist Red cases, the division is required to consult with the GRG on whether the relationship should be transferred to the GRG (see more on the GRG below). Relationships managed by the divisions tend to be with companies operating in niche sectors such as airlines or products such as securitisation special purpose vehicles. The divisions may also manage those exposures when subject matter expertise is available in the divisions rather than within the GRG.

* unaudited

At 31 December 2011, exposure to customers reported as Watchlist Red and managed within the divisions totalled £4.9 billion.

Strategies that are available within divisions include granting the 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 credit metrics of the customer, the market environment and the loan structure/security. Only those concessions deemed to be outside current market norms are reported as restructurings in the discussions below.

Other potential outcomes of the review of the relationship are to: take the customer off Watchlist and return it to the mainstream loan book; offer further lending and maintain ongoing review; transfer the relationship to the GRG for those customers requiring such stewardship; or exit the relationship altogether.

Global Restructuring Group
In cases where the Group's exposure to the customer exceeds £1 million, the relationship may be transferred to the GRG following consultation with the originating division. The GRG's primary function is active management of the exposures to minimise loss for the Group and where feasible return the exposure to the Group's mainstream loan book following an assessment by the GRG that no further losses are expected.

At 31 December 2011, credit risk assets relating to exposures under GRG management (excluding those placed under GRG stewardship for operational reasons rather than concerns over credit quality and those in the AQ10 internal asset quality (AQ) band) totalled £22 billion. Credit risk assets are defined on page 102. The internal asset quality bands are defined on page 103.

The following table shows a sector breakdown of these exposures:

Watchlist Red credit risk assets under GRG management	Core £m	Non-Core £m	Total £m
2011			
Property	6,561	6,011	12,572
Transport	1,159	2,252	3,411
Retail and leisure	1,528	669	2,197
Services	808	141	949
Other	1,952	916	2,868
Total	12,008	9,989	21,997

Types of wholesale restructurings
A number of options are available to the Group when corrective action is deemed necessary. The Group may offer a temporary covenant waiver, a recalibration of covenants and/or an amendment of restrictive covenants to mitigate a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan. Such covenant-related concessions are not included in the quantitative loan restructuring disclosures below.

The reported restructurings comprise the following types of concessions:

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

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

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

The vast majority of the restructurings reported by the Group take place within the GRG. Forgiveness of debt and exchange for equity is only available to customers in the GRG.

* unaudited

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Problem debt management continued
The wholesale restructured loan data presented in the tables below include only those arrangements that achieved legal completion during 2011 and that individually exceed respective thresholds set at divisional level, which range from nil to £10 million. This population captures approximately 71% of that proportion of the wholesale portfolio that is either on Watchlist or under GRG stewardship. Within this population, restructurings amounting to £8.6 billion achieved legal completion during 2011. A further £14.7 billion was in the process of being completed at year end (these loans are not included in the tables below). Of the loans that were subject to restructuring during 2011 by the divisions, 82% remained in the performing book at 31 December 2011. Of those restructured within the GRG during the year, 17% had been returned to satisfactory by year end.

The asset quality of the restructured loans, the sectors affected and provision coverage are as follows:

Wholesale restructurings by sector	AQ1-AQ9 (1) £m	AQ10 (2) £m	AQ10 (2) provision coverage %
2011			
Property	1,980	2,600	18
Transport	686	694	11
Non-bank financial institutions	228	420	65
Retail and leisure	503	148	24
Other	1,078	251	28
Total	4,475	4,113	22

Notes:
(1) Probability of default less than 100%.
(2) Probability of default is 100%.

The incidence of the main types of restructuring is analysed below:

Wholesale restructurings by type of arrangement	Loans by value %
2011	
Variation in margin	12
Payment holidays and loan rescheduling	87
Forgiveness of all or part of the outstanding debt	31
Other	8

Note:
(1) The total above exceeds 100% as an individual case can involve more than one type of arrangement.

Provisioning for impaired loans
Any one of the above types of restructuring may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows from the restructured loan resulting in the recognition of an impairment loss. Restructurings that include forgiveness of all or part of the outstanding debt account for the majority of such cases.

The customer's financial position, anticipated prospects and the likely effect of the restructuring, including any concessions granted, are considered in order to establish whether an impairment provision is required.

Provisions on exposures greater than £1 million are individually assessed by the GRG. Exposures smaller than £1 million are deemed not to be individually significant and are assessed collectively by the originating division.

In the case of non-performing loans that are restructured, the loan impairment provision assessment (based on management's best estimate of the incurred loss) almost invariably takes place prior to the restructuring. The quantum of the loan impairment provision may change once the terms of the restructuring are known, resulting in an additional provision charge or a release of the provision in the period the restructuring takes place.

Refer to Impairment loss provision methodology on pages 160 and 161.

Recoveries and active insolvency management
The ultimate outcome of a restructuring 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 Group holds collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. The Group's preferred strategy is to consider other possible options prior to exercising these rights.

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

Retail customers
Early problem recognition and collections
There are collections functions in each of the retail businesses. Their role is to provide support and assistance to customers who are experiencing difficulties in meeting their financial obligations to the Group. Evidence of such difficulties includes, for example, a missed payment on their loan, or a balance that is in excess of the agreed credit limit. Additionally, in UK Retail and Ulster Bank, a dedicated support team aims to identify and help customers who may be facing financial difficulty but who are current with their payments.

Within collections, a range of tools is deployed to initiate contact with the customer, establish the cause of their financial difficulty and, where possible, return the customer to a satisfactory position using, where appropriate, forbearance strategies. If these strategies are unsuccessful, the customer is transferred to the recoveries team.

Recoveries
The goal of the recoveries function is to collect the total amount outstanding and reduce the loss to the Group by maximising the level of cash recovery whilst treating customers fairly. A range of treatment options are available within recoveries, including litigation procedures for secured assets. In UK Retail and Ulster Bank, no repossession procedures are initiated until at least six months following the emergence of arrears. Additionally, certain forbearance options are made available to customers within recoveries.

Forbearance
Within the Group's retail businesses, forbearance generally occurs when the business, for reasons relating to the actual or potential financial stress of a borrower, grants a permanent or temporary concession to that borrower. Forbearance is granted following an assessment of the customer's ability to pay. It is granted principally to customers with mortgages. Granting of forbearance to unsecured customers is less extensive.

Identification of forbearance
Mortgages are identified for forbearance treatment following initial contact from the customer, in the event of payment arrears or when the customer is transferred to collections or recoveries.

Types of retail forbearance
A number of forbearance options are utilised by the Group's retail businesses. These include, but are not limited to, reduced repayments, payment holidays, capitalisations of arrears, term extensions and conversions to interest only. Within UK Retail, interest only conversions are generally made available only to those customers who are current on payments and have a defined repayment source.

The principal types of forbearance granted in RBS Citizens' mortgage portfolio are the US government mandated HAMP (Home Affordable Modification Program) and Citizens' proprietary modification programme. Both programmes typically feature a combination of term extensions, capitalisations of arrears, temporary interest rate reductions and conversions from interest only to amortising. These tend to be permanent changes to contractual terms. Borrowers seeking a modification must meet government specified qualifications for HAMP and internal qualifications for Citizens' modification programme. Both are designed to evidence that the borrower is in financial difficulty as well as demonstrating willingness to pay.

For those loans classified as non-performing, the Group's objective in granting forbearance is to minimise the loss on these accounts and wherever possible, return the customer to the performing book. For those loans that are performing, the aim is to enable the customers to continue to service the loan.

The mortgage forbearance population is reviewed regularly to ensure that customers are meeting the agreed terms of the arrangement. Key metrics have been developed to record the proportion of customers who fail to meet the agreed terms over time as well as the proportion of customers who return to a performing state with no arrears.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Problem debt management continued
The mortgage arrears information for retail accounts in forbearance and related provision arrangements are shown in the table below:

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		
Arrears status and provisions	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Accounts forborne %
2011									
UK Retail (1,2)	3,677	16	351	13	407	59	4,435	88	4.7
Ulster Bank (1,2)	893	78	516	45	421	124	1,830	247	9.1
Citizens	—	—	91	10	89	10	180	20	0.8
Wealth	121	—	—	—	2	—	123	—	1.3
Total	4,691	94	958	68	919	193	6,568	355	4.4

Notes:
(1) Includes all forbearance arrangements regardless of whether or not the customer is experiencing financial difficulty.
(2) Comprises the current stock position of forbearance deals agreed since January 2008 for UK Retail and since July 2008 for Ulster Bank.
(3) Refer to page 113 for details of the proportion of UK Retail and Citizens mortgage loans that have missed three or more payments, compared to the forbearance population above.

The incidence of the main types of retail forbearance on the balance sheet as at 31 December 2011 is analysed below. For a small proportion of mortgages, more than one forbearance type applies.

Forbearance arrangements	UK Retail (1) £m	Ulster Bank (1) £m	Citizens £m	Wealth £m	Total (2) £m
2011					
Interest only conversions	1,269	795	—	3	2,067
Term extensions - capital repayment and interest only	1,805	58	—	97	1,960
Payment concessions/holidays	198	876	180	—	1,254
Capitalisation of arrears	864	101	—	—	965
Other	517	—	—	23	540
Total	4,653	1,830	180	123	6,786

Notes:
(1) Comprises the current stock position of forbearance deals agreed since January 2008 for UK Retail and since July 2008 for Ulster Bank.
(2)

As an individual case can include more than one type of arrangement, the analysis in the table above can exceed the total forbearance.

For unsecured portfolios in UK Retail, 1.1% of the total unsecured population was subject to forbearance at 31 December 2011 and comprises either debt consolidation loans provided to customers subject to collections activity who do not meet the Group’s standard underwriting criteria or repayment arrangements where the customer's overdraft limit is increased to accommodate account excesses and/or loan arrears. Additionally, support is provided to customers experiencing financial difficulties through breathing space initiatives’ on all unsecured products, including credit cards, whereby a 30-day period is given to allow customers to establish a debt repayment plan. During this time, the Group suspends collection activity and a further extension of 30 days can be granted if progress is made and discussions are continuing. Arrears continue to accrue for customer loans benefiting from breathing space.

Within Citizens, granting of forbearance is significantly less extensive for non real estate portfolios, as it is predominantly restricted to the granting of short-term (1-3 months) loan extensions to customers 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 following the extension term. The number and frequency of extensions are limited per customer. Additionally, in the case of loans secured by vehicles and credit cards, Citizens may offer temporary interest rate modifications but no principal reduction. For loans secured by vehicles, this is now restricted to three-month interest rate modifications. For credit cards, customers may be offered short-term (6-12 months) or longer-term (up to 60 months) interest rate modifications. Citizens may also provide forbearance to student loan borrowers consistent with the policy guidelines of the US Office of the Comptroller of the Currency.

Provisioning for retail customers

Within UK Retail and Ulster Bank, provisions are assessed in accordance with the Group's provisioning policies (refer to Impairment loss provision methodology on pages 160 and 161). For the non-performing population, a collective assessment is made. Within the performing book, latent loss provisions are held for those losses that are incurred but not yet identified.

The majority of mortgage accounts subject to forbearance in these divisions remain in the performing book but are identified and monitored separately from other performing accounts. They are subject to higher provisioning rates than the remainder of the performing book (currently approximately five times higher in UK Retail and approximately eight times higher in Ulster Bank). These rates are reviewed quarterly in UK Retail and monthly in Ulster Bank. Once forbearance is granted, the account continues to be assessed separately for latent provisioning for 24 months (UK Retail only) or until the forbearance period expires. After that point, the account is no longer separately identified for latent provisioning.

Non-performing mortgage accounts that have been granted forbearance carry the same provision rate as non-forborne accounts.

In Citizens, the amount of recorded impairment depends upon whether the loan is collateral dependent. If the loan is 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 loan's carrying amount over the present value of expected future cash flows is the impairment amount.

Credit risk mitigation

Introduction*

The Group employs a number of structures and techniques to mitigate credit risk. Netting of debtor and creditor balances is undertaken in accordance with relevant regulatory and internal policies. Exposure on over-the-counter derivative and secured financing transactions is further mitigated by the exchange of financial collateral and the use of market standard documentation. Further mitigation may be undertaken in a range of transactions, from retail mortgage lending to large wholesale financing. This 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. Such techniques are used in the management of credit portfolios, typically to mitigate credit concentrations in relation to an individual obligor, a borrower group or a collection of related borrowers.

The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across the Group cover:

- The suitability of qualifying credit risk mitigation types and any conditions or restrictions applicable to those mitigants;
- The means by which legal certainty is to be established, including required documentation and all necessary steps required to establish legal rights;
- Acceptable methodologies for initial and any subsequent valuations of collateral and the frequency with which collateral is to be revalued and the use of collateral haircuts;
- Actions to be taken in the event that the value of mitigation falls below required levels;
- Management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation;

- Management of concentration risks, for example, by setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and

- Collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

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

* unaudited

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Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Credit risk mitigation continued
Corporate exposures
The type of collateral taken by the Group's commercial and corporate businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

- Physical assets - these include business assets such as stock, plant and machinery, vehicles, ships and aircraft. In general, physical assets qualify as collateral only if they can be unambiguously identified, located or traced, and segregated from uncharged assets. Assets are valued on a number of bases according to the type of security that is granted.

- Real estate - the Group takes collateral in the form of real estate, which includes residential and commercial properties. The loan amount will typically exceed the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arms length transaction by a willing seller to a willing buyer.

- Receivables - when taking a charge over receivables, the Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.

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

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

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

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

	2011		2010	
Corporate risk elements in lending and potential problem	Loans	Provisions	Loans	Provisions
loans (excluding commercial real estate)	£m	£m	£m	£m
Secured	7,782	3,369	6,526	2,564
Unsecured	2,712	1,836	2,769	1,762

Commercial real estate

The table below analyses commercial real estate lending by loan-to-value (LTV). Due to market conditions in Ireland and to a lesser extent in the UK, there is a shortage of market based data. In the absence of external valuations, the Group deploys a range of alternative approaches including internal expert judgement and indexation.

	Ulster Bank		Rest of the Group		Group	
	AQ1-AQ9	AQ10	AQ1-AQ9	AQ10	AQ1-AQ9	AQ10
LTVs	£m	£m	£m	£m	£m	£m
2011						
<= 50%	81	28	7,091	332	7,172	360
> 50% and <= 70%	642	121	14,105	984	14,747	1,105
> 70% and <= 90%	788	293	10,042	1,191	10,830	1,484
> 90% and <= 100%	541	483	2,616	1,679	3,157	2,162
> 100% and <= 110%	261	322	1,524	1,928	1,785	2,250
> 110% and <= 130%	893	1,143	698	1,039	1,591	2,182
> 130%	1,468	10,004	672	2,994	2,140	12,998
Total with LTVs	4,674	12,394	36,748	10,147	41,422	22,541
Other (1)	7	38	8,994	1,844	9,001	1,882
Total	4,681	12,432	45,742	11,991	50,423	24,423
Total portfolio average LTV (2)	140%	259%	69%	129%	77%	201%

Notes:

(1) Other performing loans of £9.0 billion include unsecured lending to commercial real estate clients, such as major UK homebuilders. The credit quality of these exposures is consistent with that of the performing portfolio overall. Other non-performing loans of £1.9 billion are subject to the Group's standard provisioning policies.

(2) Weighted average by exposure.

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Wholesale market exposures

As set out in the table below, the Group receives collateral for reverse repurchase transactions and for derivatives, typically in the form of cash, quoted debt securities or equities. The risks inherent in both types of transaction are further mitigated through master bilateral netting arrangements. 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.

	2011	2010	2009
	£bn	£bn	£bn
Reverse repurchase agreements	100.9	95.1	76.1
Securities received as collateral (1)	(98.9)	(94.3)	(74.0)
Derivative assets gross exposure	529.6	427.1	441.5
Counterparty netting	(441.6)	(330.4)	(358.9)
Cash collateral held	(37.2)	(31.1)	(33.7)
Securities received as collateral	(5.3)	(2.9)	(3.6)

Note:

(1) In accordance with normal market practice, at 31 December 2011 £95.4 billion (2010 - £93.5 billion; 2009 - £73.0 billion) had been resold or re-pledged as collateral for the Group's own transactions.

Retail exposures

Within the Group's retail book, mortgage and home equity lending portfolios are secured by residential property. The Group's portfolio of US automobile loans is secured by motor cars or other vehicles. Student loans and credit card lending are all unsecured. The vast majority of personal loans are also unsecured.

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

The value of a property intended to secure a mortgage is assessed during the loan underwriting process using industry-standard methodologies. Property values supporting home equity lending reflect either an individual appraisal or valuations generated by statistically valid automated valuation models. Property values are updated each quarter using the relevant house price index (the Halifax Quarterly Regional House Price Index in the UK, the Case-Shiller Home Value Index in the US, and the Central Statistics Office Residential Property Price Index and the Nationwide House Price Index in Ireland).

For automobile lending in the US, new vehicles are valued at cost and used vehicles at the average trade-in value. At 31 December 2011 this portfolio amounted to £4.8 billion (2010 - £5.1 billion; 2009 - £5.7 billion), all of which was fully secured and predominantly (over 99%) in the performing book.

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

Residential mortgages

The table below shows period end LTVs for the Group's residential mortgage portfolio split between performing and non-performing and calculated on a value basis. Loan balances are as at the end of the year whereas property values are calculated using the appropriate index at 30 September 2011.

	2011		2010		2009	
Residential mortgages by average LTV	Performing £m	Non-performing £m	Performing £m	Non-performing £m	Performing £m	Non-performing £m
<= 70%	60,799	1,137	59,598	1,036	55,920	791
> 70% and <= 90%	42,923	1,022	41,964	906	38,807	697
> 90% and <= 110%	17,856	990	20,104	951	23,853	754
> 110% and <= 130%	5,809	573	7,211	622	8,604	507
> 130% (1)	6,684	1,188	3,793	507	3,059	269
Total	134,071	4,910	132,670	4,022	130,243	3,018
Total portfolio average LTV (by value)	73.2%	101.4%	72.4%	91.7%	73.5%	90.1%

Note:

(1) 83% of residential mortgages with LTV > 130% are within Ulster Bank due to the continued challenging economic environment in Ireland.

Business review Risk and balance sheet management continued

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

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

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

Retail businesses - each customer account is separately scored using models based on the most material drivers of default. In general, scorecards are statistically derived using customer data. Customers are assigned a score, which in turn is mapped to a probability of default. The probabilities of default are used to support automated credit decision making and to group customers into risk pools for regulatory capital calculations.

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

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

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

Credit risk assets
In the tables and commentary below, exposure refers to credit risk assets, which consist of:

- Lending - cash and balances at central banks and loans and advances to banks and customers (including overdraft facilities, instalment credit and finance leases);
- Rate risk management; and

- Contingent obligations, primarily letters of credit and guarantees.

Reverse repurchase agreements and issuer risk (primarily debt securities - refer to pages 133 to 135) are excluded. Where relevant and unless otherwisestated, the data reflect the effect of credit mitigation techniques.

	2011	2010	2009
Divisional analysis of credit risk assets	£m	£m	£m
UK Retail	111,070	108,302	103,029
UK Corporate	105,078	108,663	111,893
Wealth	20,079	18,875	16,553
International Banking	72,737	80,166	90,613
Ulster Bank	37,781	40,750	42,042
US Retail & Commercial	56,546	51,779	52,167
Retail & Commercial	403,291	408,535	416,297
Markets	114,327	124,330	145,456
Other	64,517	36,659	3,305
Core	582,135	569,524	565,058
Non-Core	92,709	125,383	158,499
	674,844	694,907	723,557

* unaudited

Key points

- Exposure to retail portfolios within the UK Retail, Ulster Bank and US Retail & Commercial divisions remained broadly constant during the year. A reduction in wholesale portfolios was seen across all divisions, with the exception of Wealth, for which product demand and risk appetite typically have more in common with retail portfolios. Another exception was 'Other', which is driven by Treasury where growth in credit risk assets relates to exposure to central banks in the USA, the UK and Germany and is a function of the Group's liquidity requirements and cash positions.

- Non-Core exposure declined during 2011 as a result of the continued disposal and run-off of assets. Substantial de-risking was achieved though an exposure reduction of £33 billion over the year, in line with balance sheet reduction targets. Significantly, the division was able to take action to reduce exposure within the Middle East & North Africa region, which saw material volatility early in 2011 (exposure down 66%). The division also reduced single name concentration excesses, in part due to disposals in the leveraged finance book. In addition, the division's project finance business achieved a material reduction through asset sales, unwinding of trades within the markets business and legal defeasance of structured finance transactions.

Asset quality

Using the probability of default models described previously, customers are assigned credit grades and scores, which are used for internal management reporting across portfolios, including a Group level asset quality scale, as shown below.

Internal reporting and oversight of risk assets is principally differentiated by credit grades. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures, used for internal management reporting across portfolios. Accordingly, measures of risk exposure may be readily aggregated and reported at increasing levels of granularity depending on stakeholder or business need.

The table below shows credit risk assets by asset quality (AQ) band:

		2011				2010				2009		
Asset quality	Probability of default range	Core £m	Non-Core £m	Total £m	Total %	Core £m	Non-Core £m	Total £m	Total %	Core £m	Non-Core £m	Total £m
AQ1	0% - 0.034%	195,826	13,732	209,558	31.1	175,793	17,728	193,521	27.8	149,132	23,226	172,358
AQ2	0.034% - 0.048%	18,366	2,915	21,281	3.2	18,274	2,526	20,800	3.0	18,029	3,187	21,216
AQ3	0.048% - 0.095%	27,082	2,883	29,965	4.4	26,244	4,259	30,503	4.4	26,703	7,613	34,316
AQ4	0.095% - 0.381%	65,491	9,636	75,127	11.1	64,277	15,052	79,329	11.4	78,144	18,154	96,298
AQ5	0.381% - 1.076%	92,503	10,873	103,376	15.3	90,639	18,767	109,406	15.7	92,908	24,977	117,885
AQ6	1.076% - 2.153%	67,260	6,636	73,896	11.0	73,367	12,913	86,280	12.4	76,206	18,072	94,278
AQ7	2.153% - 6.089%	36,567	8,133	44,700	6.6	41,399	10,451	51,850	7.5	44,643	15,732	60,375
AQ8	6.089% - 17.222%	11,921	3,320	15,241	2.3	15,300	4,308	19,608	2.8	18,923	4,834	23,757
AQ9	17.222% - 100%	12,710	5,024	17,734	2.6	11,398	8,621	20,019	2.9	11,589	8,074	19,663
AQ10	100%	20,029	25,020	45,049	6.7	18,003	25,005	43,008	6.2	16,756	22,666	39,422
Other (1)		34,380	4,537	38,917	5.7	34,830	5,753	40,583	5.9	32,025	11,964	43,989
		582,135	92,709	674,844	100.0	569,524	125,383	694,907	100.0	565,058	158,499	723,557

Note:

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

* unaudited

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Business review Risk and balance sheet management continued

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

	2011		2010		2009	
AQ10 credit risk assets by division	AQ10 £m	% of divisional credit risk assets	AQ10 £m	% of divisional credit risk assets	AQ10 £m	% of divisional credit risk assets
UK Retail	5,097	4.6	5,017	4.6	4,846	4.7
UK Corporate	5,484	5.2	5,198	4.8	5,612	5.0
Wealth	12	0.1	9	—	11	0.1
International Banking	1,736	2.4	2,227	2.8	1,406	1.6
Ulster Bank	6,305	16.7	4,348	10.7	2,741	6.5
US Retail & Commercial	646	1.1	599	1.2	506	1.0
Retail & Commercial	19,280	4.8	17,398	4.3	15,122	3.6
Markets	749	0.6	605	0.5	1,634	1.1
Core	20,029	3.4	18,003	3.2	16,756	3.0
Non-Core	25,020	27.0	25,005	19.9	22,666	14.3
	45,049	6.7	43,008	6.2	39,422	5.5

AQ10 credit risk assets by sector	2011 £m	2010 £m	2009 £m
Personal	8,398	7,620	6,955
Property	25,558	23,672	20,145
Banks and financial institutions	1,934	1,981	1,928
Transport and storage	1,720	1,689	1,026
Other	7,528	8,046	9,368
	45,138	43,008	39,422

Key points

- Trends in the asset quality of the Group's credit risk exposures in 2011 reflected changes in the composition of the Core portfolio in line with the re-balancing achieved through the Group's sector concentration framework, the run-off of Non-Core assets and changes in the external environment. Significant deposits were placed with central banks and this resulted in a large increase in the Group's exposures within the AQ1 band.

- Overall, the asset quality of the Group's corporate exposure was broadly maintained despite the difficult external conditions in the UK, with moderate weakening of credit quality in the Core divisions.

- A notable exception is Ulster Bank, where weakness in the Irish property sector continued to impact portfolio trends and the stock of defaulted assets in the Core book (AQ10) continued to grow. Refer to the section on Ulster Bank on page 117 for more details.

- In line with expectations, the percentage of defaulted assets in the Non-Core division increased following the run-off and disposal of performing assets. Weaknesses in the commercial real estate market continued to be the main driver of defaulted assets within Non-Core.

* unaudited

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

The table below details credit risk assets by sector and geographical region. Sectors are based on mappings aligned to the Group's sector concentration framework. Geographical region is based on country of incorporation.

Credit risk assets by sector and geographical region

2011	UK £m	Western Europe (excl. UK) £m	North America £m	Asia Pacific £m	Latin America £m	Other (1) £m	Total £m	Core £m	Non-Core £m
Personal	126,945	20,253	33,087	1,604	158	1,114	183,161	176,201	6,960
Banks	4,720	39,290	3,952	11,149	1,740	7,324	68,175	67,614	561
Other financial institutions	17,939	17,503	13,595	3,108	5,841	1,159	59,145	48,765	10,380
Sovereign (2)	21,072	34,258	31,444	3,463	78	1,581	91,896	90,638	1,258
Property	60,099	27,282	8,052	1,370	3,471	1,480	101,754	58,324	43,430
Natural resources	6,553	7,218	8,159	3,805	1,078	2,508	29,321	25,191	4,130
Manufacturing	9,583	7,480	7,098	2,126	1,011	1,381	28,679	26,614	2,065
Transport (3)	13,790	7,705	4,951	5,433	2,500	5,363	39,742	27,531	12,211
Retail and leisure	22,775	6,110	5,762	1,488	1,041	675	37,851	32,775	5,076
Telecommunications, media and technology	5,295	4,941	3,202	1,944	139	609	16,130	12,180	3,950
Business services	17,851	3,718	6,205	910	629	206	29,519	26,830	2,689
	306,622	175,758	125,507	36,400	17,686	23,400	685,373	592,663	92,710
2010 (4)									
Personal	124,594	21,973	34,970	1,864	126	1,531	185,058	174,287	10,771
Banks	6,819	35,619	5,097	11,072	1,394	6,713	66,714	65,494	1,220
Other financial institutions	17,550	14,782	14,773	4,200	8,732	1,762	61,799	47,227	14,572
Sovereign (2)	20,209	24,826	18,088	3,243	125	1,789	68,280	66,556	1,724
Property	65,622	30,925	9,573	1,980	3,090	1,750	112,940	60,590	52,350
Natural resources	6,696	7,863	9,771	3,655	1,396	4,143	33,524	24,427	9,097
Manufacturing	10,599	8,532	6,744	2,673	917	2,059	31,524	28,088	3,436
Transport (3)	13,842	8,726	5,389	6,161	2,658	6,347	43,123	27,899	15,224
Retail and leisure	24,716	6,690	5,316	1,438	1,174	918	40,252	34,100	6,152
Telecommunications, media and technology	5,495	5,764	3,283	2,187	328	786	17,843	12,076	5,767
Business services	19,757	5,116	6,521	985	1,086	385	33,850	28,780	5,070
	315,899	170,816	119,525	39,458	21,026	28,183	694,907	569,524	125,383

For notes relating to this table refer to page 106.

* unaudited

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Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Credit risk measurement*: Credit risk assets by sector and geographical region continued

2009	UK £m	Western Europe (excl. UK) £m	North America £m	Asia Pacific £m	Latin America £m	Other (1) £m	Total £m	Core £m	Non-Core £m
Personal	120,193	23,597	37,680	1,374	63	897	183,804	165,143	18,661
Banks	7,850	36,705	4,975	9,121	1,378	2,137	62,166	58,246	3,920
Other financial institutions	14,800	14,125	17,697	4,820	8,441	1,473	61,356	43,762	17,594
Sovereign (2)	18,172	27,421	4,038	3,950	414	2,217	56,212	53,595	2,617
Property	72,768	35,558	11,221	3,507	3,127	1,440	127,621	74,892	52,729
Natural resources	7,876	9,460	9,817	3,029	3,523	4,972	38,677	26,058	12,619
Manufacturing	11,197	14,875	8,718	3,695	1,306	2,633	42,424	33,400	9,024
Transport (3)	14,097	7,033	7,287	5,294	2,604	7,140	43,455	28,362	15,093
Retail and leisure	25,811	8,236	6,148	3,602	1,205	1,691	46,693	35,580	11,113
Telecommunications, media and technology	6,128	8,340	4,854	2,040	680	1,409	23,451	13,645	9,806
Business services	20,497	6,772	6,950	1,137	1,439	903	37,698	32,375	5,323
	319,389	192,122	119,385	41,569	24,180	26,912	723,557	565,058	158,499

Notes:
(1) Comprises Central and Eastern Europe, Middle East, Central Asia and Africa, and supranationals such as the World Bank.
(2) Includes central bank exposures.
(3) Excludes net investment in operating leases in shipping and aviation portfolios as they are accounted for as property, plant and equipment. However, operating leases are included in the monitoring and management of these portfolios.
(4) 2010 data were restated due to supranational counterparties being re-mapped from Western Europe to Other.

Key points

- Conditions in the financial markets and the Group's focus on risk appetite and sector concentration had a direct impact on the composition of its Core portfolio during the year. The following key trends were observed:

  (i) A 35% increase in exposure to sovereigns, driven by thesignificantdeposits placed with central banks;
  (ii) A 10% reduction in exposure to the property sector, driven by tightened controls in Core as well as by a reduction in Non-Core;
  (iii) A modest reduction in exposure to other corporate and financialinstitution sectors, driven by subdued borrowing activity by largercorporates;and
  (iv) A broadly flat exposure to the personal sector.

- The Group's sovereign portfolio comprises central governments, central banks and sub-sovereigns such as local authorities, primarily in the Group's key markets in the UK, Western Europe and the US. Exposure predominantly comprises cash balances placed with central banks such as the Bank of England, the Federal Reserve and the Eurosystem (including the European Central Bank and central banks in the eurozone) and consequently, the asset quality of this portfolio is high. Exposure to sovereigns fluctuates according to the Group's liquidity requirements and cash positions, which determine the level of cash placed with central banks. However, during 2011, there was a marked increase in these balances as the Group boosted its regulatory liquidity position. Information on the Group's exposure to sovereigns, including eurozone peripheral sovereigns, can be found in the Country risk section on page 166.

- The bank sector is one of the largest in the Group's portfolio but the sector is well diversified geographically, largely collateralised and tightly controlled through a combination of the single name concentration framework and a suite of credit policies specifically tailored to the sector and country limits. The largest segment of exposure to the sector remains to globally systemically important financial institutions. The environment remains challenging as a result of low economic growth in advanced economies, higher costs due to increased regulatory requirements and the growing difficulty of returning to historical levels of profitability. Over 2011, there was modest increase in exposure to banks due to mark-to-market movements in derivatives. However, the Group's portfolio was in general characterised by declining limits, a rising number of counterparties subject to heightened credit monitoring due to the problems faced by the peripheral eurozone countries and a corresponding deterioration in asset quality, balanced to some extent by the improved stability of banks outside the eurozone.

* unaudited

- The other financial institutions sector comprises traded and non-traded products and is spread across a wide range of financial companies including insurance companies, securitisation vehicles, financial intermediaries including central counterparties (CCPs), financial guarantors - monolines and credit derivative product companies (CDPCs) - and unleveraged, hedge and leveraged funds. The size and asset quality of this portfolio are stable and have not changed materially since 2010. However, entities in this sector remain vulnerable to market shocks or contagion from the banking sector crisis. Credit risk for these sectors is managed through both the sector concentration and asset and product class frameworks, with specific sector and product caps introduced where there is a perception of heightened credit risk, such as with leveraged funds and insurance holding companies. Additionally, policies were tightened for riskier products to entities in this portfolio, such as committed lending, to reduce risks from a customer default. During the year, a comprehensive securitisation framework was established to cap the securitisation portfolio and to control concentrations to the underlying asset classes and originators. The Group is currently reassessing its risk appetite framework for CCPs to reflect increases in activity with these entities, as a result of regulatory requirements for derivatives to be cleared through CCPs. In 2011, the Group continued to manage down its exposures to monolines and CDPCs and was successful in commuting trades with entities in this portfolio.

- The Group's exposure to the property sector totals £102 billion (a reduction of 10% during the year), the majority of which is commercial real estate (refer to page 108 for further detail). The remainder comprises lending to construction companies, housing associations and building material companies. The majority of property exposure (with the exception of Non-Core) is within UK Corporate (63%). Asset quality in other property sub-sectors remained stable during the year and whilst there are some material single name concentrations in the construction sector due to industry consolidation, overall appetite remains controlled through the sector concentration limits framework.

- The exposure to the retail sector attracts heightened scrutiny due to its cyclical nature. Stress testing has confirmed that the retail sector has an above average vulnerability to a high UK inflation and interest rate scenario. Certain sub-sectors have proven less vulnerable to macroeconomic volatilities (e.g. food and beverage) as have larger retailers with well established brands and multiple channel offerings. Total exposure declined 6% during 2011. Despite recent high profile failures of UK high street retailers, loss experience on the RBS retail portfolio over 2011 was low, following the earlier exit from some parts of the portfolio. The portfolio is generally well diversified by geography and by counterparty.

- The leisure sector displays weaker credit metrics than the wider corporate portfolio, in line with the industry trend. Default experience in hotels and restaurants is particularly high. The Group's risk appetite towards the sector is driven by the importance of the leisure sector to the UK franchise, especially for the UK Corporate division, but is mitigated through tighter origination policies and guidelines and a reduction in exposure to high risk sub-sectors. The gaming sub-sector is subject to specific controls due to its inherent high credit and reputational risk profile.

- The Group's transport sector includes £11.7 billion of asset-backed exposure to ocean-going vessels. The downturn observed in the shipping sector since 2008 continued during 2011, with further pressure on second-hand values and deliveries of new build vessels into poor markets. A key protection for the Group is the minimum security covenant. This covenant is tested each quarter on an individual vessel basis to ensure that prompt remedial action is taken if values fall significantly below agreed loan coverage ratios. At 31 December 2011, 1% of the Group's exposure to this sector was in Watchlist Red.

- Exposure to the healthcare and education sectors is included in the business services sector and totalled £13.4 billion at year-end. It is mostly UK focused and is heavily biased towards the health sector, which represents 74%

of the exposure. The sector has performed well despite the difficult economic conditions but there are continuing uncertainties over the impact of Government spending reductions. Key concerns remain over the nursing home sub-sector, where the lower end of the elderly care home book saw an increased rate of customers being placed on Watchlist and higher defaults over 2011. Actions were taken to rebalance the portfolio towards the stronger operators.

* unaudited

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Key credit portfolios*

Commercial real estate
The commercial real estate lending portfolio totalled £74.8 billion at 31 December 2011, a 14% year-on-year decrease (2010 - £87.4 billion). The commercial real estate sector comprises exposure to entities involved in the development of or investment in commercial and residential properties (including homebuilders). The analysis below excludes rate risk management and contingent obligations.

	2011			2010			2009		
	Investment	Development	Total	Investment	Development	Total	Investment	Development	Total
By division	£m	£m	£m	£m	£m	£m	£m	£m	£m
Core									
UK Corporate	25,101	5,023	30,124	24,879	5,819	30,698	27,143	7,331	34,474
Ulster Bank	3,882	881	4,763	4,284	1,090	5,374	6,131	3,838	9,969
US Retail & Commercial	4,235	70	4,305	4,322	93	4,415	2,812	1,084	3,896
Markets	141	61	202	191	275	466	1,275	193	1,468
International Banking	872	299	1,171	940	369	1,309	722	625	1,347
	34,231	6,334	40,565	34,616	7,646	42,262	38,083	13,071	51,154
Non-Core									
UK Corporate	3,957	2,020	5,977	7,591	3,263	10,854	7,390	3,959	11,349
Ulster Bank	3,860	8,490	12,350	3,854	8,760	12,614	2,061	6,271	8,332
US Retail & Commercial	901	28	929	1,325	70	1,395	1,409	431	1,840
International Banking	14,689	336	15,025	19,906	379	20,285	24,638	873	25,511
	23,407	10,874	34,281	32,676	12,472	45,148	35,498	11,534	47,032
Total	57,638	17,208	74,846	67,292	20,118	87,410	73,581	24,605	98,186

	Investment		Development			Investment		Development		
	Commercial	Residential	Commercial	Residential	Total	Core	Non-Core	Core	Non-Core	Total
By geography	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2011										
UK (excluding NI) (1)	28,653	6,359	1,198	6,511	42,721	25,904	9,108	5,118	2,591	42,721
Ireland (ROI & NI) (1)	5,146	1,132	2,591	6,317	15,186	3,157	3,121	793	8,115	15,186
Western Europe	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	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

2010 (1)										
UK (excluding NI) (1)	32,334	7,255	1,520	8,288	49,397	26,168	13,421	5,997	3,811	49,397
Ireland (ROI & NI) (1)	5,056	1,148	2,785	6,578	15,567	3,159	3,044	963	8,401	15,567
Western Europe	10,568	643	25	42	11,278	409	10,802	25	42	11,278
US	7,345	1,296	69	175	8,885	4,636	4,005	173	71	8,885
RoW	1,622	25	138	498	2,283	244	1,404	488	147	2,283
	56,925	10,367	4,537	15,581	87,410	34,616	32,676	7,646	12,472	87,410
2009 (1)										
UK (excluding NI) (1)	36,801	7,042	1,875	10,499	56,217	29,230	14,613	7,654	4,720	56,217
Ireland (ROI & NI) (1)	5,314	1,047	3,484	5,961	15,806	4,664	1,697	3,530	5,915	15,806
Western Europe	12,565	840	184	225	13,814	905	12,500	215	194	13,814
US	6,522	1,355	881	778	9,536	3,193	4,684	1,289	370	9,536
RoW	2,068	27	239	479	2,813	91	2,004	383	335	2,813
	63,270	10,311	6,663	17,942	98,186	38,083	35,498	13,071	11,534	98,186

Note:

(1) ROI: Republic of Ireland; NI: Northern Ireland.

*unaudited

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By sub-sector	UK (excl NI) £m	Ireland (ROI & NI) £m	Western Europe £m	US £m	RoW £m	Total £m
2011						
Residential	12,871	7,449	1,096	1,325	319	23,060
Office	7,155	1,354	2,248	404	352	11,513
Retail	8,709	1,641	1,893	285	275	12,803
Industrial	4,317	507	520	24	105	5,473
Mixed/other	9,669	4,235	3,001	4,898	194	21,997
	42,721	15,186	8,758	6,936	1,245	74,846
2010						
Residential	15,543	7,726	685	1,471	523	25,948
Office	8,539	1,178	2,878	663	891	14,149
Retail	10,607	1,668	1,888	1,025	479	15,667
Industrial	4,912	515	711	80	106	6,324
Mixed/other	9,796	4,480	5,116	5,646	284	25,322
	49,397	15,567	11,278	8,885	2,283	87,410
2009						
Residential	17,197	7,352	1,065	2,134	505	28,253
Office	9,381	1,536	5,034	1,614	975	18,540
Retail	5,760	686	998	492	700	8,636
Industrial	11,378	2,599	3,592	2,053	402	20,024
Mixed/other	12,501	3,633	3,125	3,243	231	22,733
	56,217	15,806	13,814	9,536	2,813	98,186

Note:

(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 £1.3 billion at 31 December 2011 continues to perform in line with expectations and requires minimal provision.

Key points

- In line with the Group's strategy, exposure to commercial real estate was reduced during 2011, affecting mainly the UK and Western Europe given that these regions account for the majority of the portfolio. Overall this portfolio decreased circa 25% from the end of 2009 to the end of 2011.

- Most of the decrease is in Non-Core due to run-off and asset sales. The Non-Core portfolio totalled £34.3 billion (46% of the portfolio) at 31 December 2011 (2010 - £45.1 billion, or 52% of the portfolio) and includes exposures in Ulster Bank as discussed on page 118.

- With the exception of exposure in Spain and in Ireland, the Group has minimal commercial real estate exposure to other eurozone periphery countries. Exposure in Spain is predominantly in the Non-Core portfolio and totals £2.3 billion, of which 36% is in AQ1-AQ9. The remainder of the Spanish portfolio has already been subject to material write-off and provision levels have been assessed based on re-appraised values. There are significant differences in values based on geographic location and asset type.

- The UK portfolio is focused on London and the South East (44%), with the remainder well spread across the UK regions.

- Short-term lending to property developers without sufficient pre-let revenue at origination to support investment financing after practical completion is classified as speculative. Speculative lending at origination represents approximately 1% of the portfolio. The Group's appetite for originating speculative commercial real estate lending is very limited and any such business requires senior management approval.

- The commercial real estate market is expected to remain challenging in key markets and new business will be accommodated from run-off of existing Core exposure. As liquidity in the market remains tight, the Group is focusing on re-financings and supporting its existing client base.

* unaudited

Business review Risk and balance sheet management continued

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

Maturity profile of portfolio	UK Corporate £m	International Banking £m	Ulster Bank £m	US Retail & Commercial £m	Markets £m	Total £m
2011						
Core						
< 1 year (1)	8,268	142	3,030	1,056	—	12,496
1-2 years	5,187	218	391	638	60	6,494
2-3 years	3,587	231	117	765	132	4,832
> 3 years	10,871	580	1,225	1,846	10	14,532
Not classified (2)	2,211	—	—	—	—	2,211
Total	30,124	1,171	4,763	4,305	202	40,565
Non-Core						
< 1 year (1)	3,224	7,093	11,089	293	—	21,699
1-2 years	508	3,064	692	163	—	4,427
2-3 years	312	1,738	177	152	—	2,379
> 3 years	1,636	3,126	392	321	—	5,475
Not classified (2)	297	4	—	—	—	301
Total	5,977	15,025	12,350	929	—	34,281
2010						
Core						
< 1 year (1)	7,563	448	2,719	1,303	442	12,475
1-2 years	5,154	223	829	766	24	6,996
2-3 years	4,698	221	541	751	—	6,211
> 3 years	10,361	417	1,285	1,595	—	13,658
Not classified (2)	2,922	—	—	—	—	2,922
Total	30,698	1,309	5,374	4,415	466	42,262
Non-Core						
< 1 year (1)	4,829	3,887	10,809	501	—	20,026
1-2 years	1,727	6,178	983	109	—	8,997
2-3 years	831	3,967	128	218	—	5,144
> 3 years	2,904	6,253	694	567	—	10,418
Not classified (2)	563	—	—	—	—	563
Total	10,854	20,285	12,614	1,395	—	45,148

Notes:
(1) Includes on demand and past due assets.
(2) Predominantly comprises multi-option facilities for which there is no single maturity date.

Key point
- The majority of Ulster Bank Group's commercial real estate portfolio is categorised as < 1 year, including on demand assets, owing to the high level of non-performing assets in the portfolio. Ulster Bank places most

restructured facilities on demand rather than extending the maturity date.

* unaudited

Breakdown of portfolio by asset quality (AQ) band

	AQ1-AQ2	AQ3-AQ4	AQ5-AQ6	AQ7-AQ8	AQ9	AQ10	Total
2011	£m	£m	£m	£m	£m	£m	£m
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
Total	1,774	8,001	25,005	10,147	5,496	24,423	74,846
2010							
Core	1,055	7,087	20,588	7,829	2,171	3,532	42,262
Non-Core	1,003	2,694	11,249	7,608	4,105	18,489	45,148
Total	2,058	9,781	31,837	15,437	6,276	22,021	87,410

Key points

- Approximately 13% of the commercial real estate exposure is within the AQ1-AQ4 bands. This includes unsecured lending to property companies and real estate investment trusts. The high proportion of the exposure in the AQ10 band is driven by Ulster Bank Group (Core and Non-Core) and International Banking (Non-Core).

- Of the total portfolio of £74.8 billion at 31 December 2011, £34.7 billion (2010 - £45.1 billion) is managed within the Group's standard credit processes and £5.9 billion (2010 - £9.2 billion) is receiving varying degrees of heightened credit management under the Group Watchlist process (this includes all Watchlist Amber cases and Watchlist Red cases managed outside the Global Restructuring Group (GRG)). A further £34.3 billion (2010 - £33.1 billion) is managed within the GRG and includes both Watchlist and non-performing exposures. The increase in the portfolio managed by the GRG is driven by Ulster Bank Group (Core and Non-Core).

The table below analyses commercial real estate lending by loan-to-value (LTV). Due to market conditions in Ireland and to a lesser extent in the UK, there is a shortage of market based data. In the absence of external valuations, the Group deploys a range of alternative approaches including internal expert judgement and indexation.

	Ulster Bank		Rest of the Group		Group	
	AQ1-AQ9	AQ10	AQ1-AQ9	AQ10	AQ1-AQ9	AQ10
LTVs	£m	£m	£m	£m	£m	£m
2011						
<= 50%	81	28	7,091	332	7,172	360
> 50% and <= 70%	642	121	14,105	984	14,747	1,105
> 70% and <= 90%	788	293	10,042	1,191	10,830	1,484
> 90% and <= 100%	541	483	2,616	1,679	3,157	2,162
> 100% and <= 110%	261	322	1,524	1,928	1,785	2,250
> 110% and <= 130%	893	1,143	698	1,039	1,591	2,182
> 130%	1,468	10,004	672	2,994	2,140	12,998
Total with LTVs	4,674	12,394	36,748	10,147	41,422	22,541
Other (1)	7	38	8,994	1,844	9,001	1,882
Total	4,681	12,432	45,742	11,991	50,423	24,423
Total portfolio average LTV (2)	140%	259%	69%	129%	77%	201%

Notes:

(1) Other performing loans of £9.0 billion include unsecured lending to commercial real estate clients, such as major UK homebuilders. The credit quality of these exposures is consistent with that of the performing portfolio overall. Other non-performing loans of £1.9 billion are subject to the Group's standard provisioning policies.

(2) Weighted average by exposure.

Key points

- Nearly 85% of the commercial real estate portfolio with LTV > 100% is within Ulster Bank Group (Core and Non-Core) and International Banking (Non-Core). A majority of portfolios are managed within the GRG and are subject to monthly reviews. Significant levels of provisions have been taken against these portfolios; provisions as a percentage of risk elements in lending for the Ulster Bank Group commercial real estate portfolio were 53% at 31 December 2011 (2010 - 44%). The reported LTV levels are based on gross loan values. The weighted average LTV for AQ10 excluding Ulster Bank is 129%.
- The average interest coverage ratios (ICR) for UK Corporate (Core and Non-Core) and International Banking (Non-Core) investment properties are 2.71x and 1.25x respectively. The US Retail & Commercial portfolio is managed on the basis of debt service coverage, which includes scheduled principal amortisation. The average debt service interest coverage for this portfolio on this basis was 1.24x at 31 December 2011. There are a number of different approaches used within the Group and across the industry to calculate ICR. Ratios for different portfolio types, and organisations may not therefore be comparable.

* unaudited

Business review Risk and balance sheet management continued

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

Personal credit loans and receivables	2011 £m	2010 £m	2009 £m
UK Retail			
- mortgages	96,388	92,592	85,529
- cards, loans and overdrafts	16,004	18,072	20,316
Ulster Bank			
- mortgages	20,020	21,162	22,304
- other personal	1,533	1,017	1,172
Citizens			
- mortgages	23,829	24,575	26,534
- auto and cards	5,731	6,062	6,917
- other (1)	2,111	3,455	4,205
Other (2)	17,545	18,123	16,827
	183,161	185,058	183,804

Notes:
(1) Mainly student loans and loans secured by recreational vehicles or marine vessels.
(2) Personal exposures in other divisions.

Residential mortgages
The tables below detail the distribution of residential mortgages by indexed LTV. LTV averages are calculated by transaction volume and transaction value. Refer to the section on Ulster Bank Group on page 117 for analysis of residential mortgages.

LTV distribution calculated on a volume basis	UK Retail			Citizens		
	2011 %	2010 %	2009 %	2011 %	2010 %	2009 %
<= 70%	62.1	61.6	60.2	43.5	43.4	43.6
> 70% and <= 90%	27.1	26.2	24.5	26.9	27.6	26.8
> 90% and <= 110%	9.4	10.4	12.5	16.7	17.2	18.0
> 110% and <= 130%	1.4	1.7	2.7	6.9	6.0	5.4
> 130%	—	0.1	0.1	6.0	5.8	6.2
Total portfolio average LTV at 31 December	57.8	58.2	59.1	73.8	75.3	74.5
Average LTV on new originations during the year	58.4	64.2	67.2	63.8	64.8	62.6

LTV distribution calculated on a value basis	2011 £m	2010 £m	2009 £m	2011 £m	2010 £m	2009 £m
<= 70%	47,811	44,522	37,666	9,669	10,375	11,675
> 70% and <= 90%	34,410	32,299	28,280	7,011	7,196	7,440

> 90% and <= 110%	11,800	12,660	15,112	3,947	4,080	4,569
> 110% and <= 130%	1,713	1,924	3,104	1,580	1,488	1,486
> 130%	74	73	86	1,263	1,252	1,540
Total portfolio average LTV at 31 December	67.2%	68.1%	70.4%	75.9%	75.4%	74.7%
Average LTV on new originations during the year	63.0%	68.0%	70.3%	65.8%	65.3%	64.4%

* unaudited

	2011	2010	2009
Residential mortgages which are three months or more in arrears (by volume)	%	%	%
UK Retail (1)	1.6	1.7	1.6
Citizens	2.0	1.4	1.5

Note:
(1) The 'One Account' current account mortgage is excluded (£5.4 billion - 5.6% of assets) at 31 December 2011, 0.9% of these accounts were 90 days continually in excess of the limit (2010 - 0.8%). Consistent with the way the Council of Mortgage Lenders publishes member arrears information, the 3+ months arrears rate now excludes accounts in repossession and cases with shortfalls post property sale.

Key points
UK Retail

- The UK Retail mortgage portfolio totalled £96.4 billion (98.6% in Core) at 31 December 2011, an increase of 4.1% from 2010, due to continued strong sales growth and lower redemption rates from before the financial crisis.

- Of the total portfolio, 98.6% is designated as Core business, primarily comprising mortgages branded the Royal Bank of Scotland, NatWest, the One Account and First Active. Non-Core comprises Direct Line Mortgages.

- The assets are prime mortgages and include 7.2% (£6.9 billion) of exposure to residential buy-to-let. There is a small legacy self-certification book (0.3% of total assets). Self-certified mortgages were withdrawn from sale in 2004.

- Gross new mortgage lending in 2011 remained strong at £14.7 billion. The average LTV for new business during 2011 declined in comparison to 2010 and the maximum LTV available to new customers remained at 90%. Based on the Halifax House Price index at September 2011, the book average indexed LTV improved marginally when compared to December 2010, with the proportion of balances with an LTV over 100% also lower. Refer to the table on page 117, which details LTV information on a volume and value basis.

- The arrears rate (more than three payments in arrears, excluding repossessions and shortfalls post property sale) has remained broadly stable since late 2009 at 1.6%.

- The number of properties repossessed in 2011 was 1,671, up from 1,392 in 2010.

- The mortgage impairment charge was £187 million for 2011, an increase of 2% from 2010. A significant part of the mortgage impairment charge related to reduced expectations of cash recovery on already defaulted debt. It also included an additional provision charge for mortgage customers who received forbearance.

- Default and arrears rates remain sensitive to economic developments and are currently supported by the low interest rate environment and strong book growth, with recent business yet to fully mature.

Citizens

- Citizens' residential mortgage portfolio totalled £23.8 billion at 31 December 2011, a reduction of 3% from 2010 (£24.6 billion).

- The mortgage portfolio comprises £6.4 billion of residential mortgages (99% in first lien position: Core - £5.8 billion; Non-Core - £0.6 billion) and £17.4 billion of home equity loans and lines (41% in first lien position: Core - £14.9 billion; Non-Core - £2.5 billion). Home equity Core consists of 47% in first lien position.

- Citizens continues to focus on the ‘footprint’ states of New England, Mid Atlantic and Mid West, targeting low risk products and maintaining conservative risk policies. At 31 December 2011, the portfolio consisted of £19.5 billion (82% of the total portfolio) within footprint.

- Loan acceptance criteria were tightened during 2009 to address deteriorating economic and market conditions.

- Non-Core comprises 13% of the residential mortgage portfolio. Its largest component (74%) is the serviced by others (SBO) home equity portfolio. The SBO portfolio consists of purchased pools of home equity loans and lines, which resulted in an annualised charge-off rate of 8.7% in 2011. It is characterised by out-of-footprint geographies, high second lien concentration (95%) and high average LTV (113% at 31 December 2011). The SBO book has been closed to new purchases since the third quarter of 2007 and is in run-off, with exposure down from £2.8 billion in 2010, to £2.3 billion at 31 December 2011. The arrears rate of the SBO portfolio decreased from 3.0% in 2010, to 2.3% at 31 December 2011, as the legacy of poorer assets receded, and account servicing and collections became more effective following a servicer conversion in 2009.

* unaudited

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Key credit portfolios* continued
Retail credit assets: Personal lending
The Group’s personal lending portfolio includes credit cards, unsecured loans, auto finance and overdrafts. The majority of personal lending exposures exist in the UK and the US. Impairment charges as a proportion of average loans and receivables are shown in the following table.

	2011		2010		2009	
	Average loans and receivables	Impairment charge as a % of average loans and receivables	Average loans and receivables	Impairment charge as a % of average loans and receivables	Average loans and receivables	Impairment charge as a % of average loans and receivables
Personal lending	£m	%	£m	%	£m	%
UK Retail cards (1)	5,675	3.0	6,025	5.0	6,101	8.7
UK Retail loans (1)	7,755	2.8	9,863	4.8	12,062	5.9
Citizens cards (2)	936	5.1	1,005	9.9	1,145	9.7
Citizens auto loans (2)	4,856	0.2	5,256	0.6	6,306	1.2

Notes:
(1) The ratio for UK Retail assets refers to the impairment charges for the year. This is the Core UK loans book and excludes the Non-Core direct loans book that was sold in late 2011.
(2) The ratio for Citizens refers to the impairment charges in the year, net of recoveries realised in the year.

Key points
UK Retail
- The UK personal lending portfolio, of which 99.4% is in Core businesses, comprises credit cards, unsecured loans and overdrafts, and totalled £16.0 billion at 31 December 2011 (2010 - £18.1 billion).
- The decrease in portfolio size of 11.6% was driven by continued subdued loan recruitment activity and a continuing general market trend of customers repaying unsecured debt.
- The Non-Core portfolio consists of the direct finance loan portfolios (Direct Line, Lombard, Mint and Churchill) and totalled £0.1 billion at 31 December 2011 (2010 - £0.4 billion). In the last quarter of 2011, a portfolio of £170 million of balances was disposed of.
- Risk appetite continues to be actively managed across all products with investment in collection and recovery processes continuing, addressing both continued support for the Group’s customers and the management of impairments.
- Support continues for customers experiencing financial difficulties through ‘breathing space initiatives’. Refer to the disclosures on forbearance on page 98 for more information.
- The impairment charge on unsecured lending was £579 million for the year, down 42% on 2010, reflecting the effect of risk appetite tightening. The sale of the direct finance loan book gave rise to a one-off benefit of

approximately £30 million.

- Impairments remain sensitive to the external environment, including unemployment levels and interest rates.

- Industry benchmarks for cards arrears remain stable, with the Group continuing to perform favourably.

Citizens

- Citizens’ average credit card portfolio totalled £936 million during 2011, with Core assets comprising 90.2% of the portfolio. Citizens’ cards business has traditionally adopted conservative risk strategies compared with the US market and given the economic climate, has introduced tighter lending criteria and lower credit limits. These actions have led to improving new business quality and a business performing better than industry benchmarks (provided by VISA). The latest available metrics show the 60+ days delinquency as a percentage of total outstandings at 2.15% at November 2011 (compared to an industry figure of 2.45%) and net contractual charge-offs as a percentage of total outstandings at 2.89% at November 2011 (compared to an industry figure of 3.69%).

- Citizens’ average auto loan portfolio totalled £4.9 billion during 2011, of which 98% is considered Core. £101 million (2%) is Non-Core and anticipated to run off by 2013. Citizens’ vehicle financing business lends to US consumers through a network of 4,200 auto dealers in 25 US states. Citizens’ credit policy is considered conservative, targeting prime customers and has historically experienced credit losses below those of industry peers.

- The net write-off rate on the total auto portfolio fell to 0.18% at 31 December 2011, from 0.34% in 2010. The 30+ days past due delinquency rate fell to 1.04% at 31 December 2011, from 1.57% in 2010.

*unaudited

Ulster Bank Group (Core and Non-Core)
At 31 December 2011, Ulster Bank Group accounted for 10% of the Group's total customer loans (2010 - 10%; 2009 - 10%) and 9% of the Group's Core customer loans (2010 - 9%; 2009 - 9%). Ulster Bank's financial performance continues to be overshadowed by the challenging economic climate in Ireland, with impairments remaining elevated as high unemployment, coupled with higher taxation and limited liquidity in the economy, continues to depress the property market and domestic spending.

The impairment charge of £3,717 million for 2011 (2010 - £3,843 million; 2009 - £1,926 million) was driven by a combination of new defaulting customers and deteriorating security values. Provisions as a percentage of risk elements in lending increased from 44% in 2010, to 53% at 31 December 2011, predominantly as a result of the deterioration in the value of the Non-Core commercial real estate development portfolio.

Core
The impairment charge for the year of £1,384 million (2010 - £1,161 million; 2009 - £649 million) reflects the difficult economic climate in Ireland, with elevated default levels across both mortgage and other corporate portfolios. The mortgage sector accounted for £570 million (41%) of the total 2011 impairment charge.

Non-Core
The impairment charge for the year was £2,333 million (2010 - £2,682 million; 2009 - £1,277 million), with the commercial real estate sector accounting for £2,160 million (93%) of the total 2011 charge.

Loans, risk elements in lending (REIL) and impairments by sector

2011	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Mortgages	20,020	2,184	945	10.9	43	4.7	570	11
Personal unsecured	1,533	201	184	13.1	92	12.0	56	25
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
	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
Personal unsecured	1,533	201	184	13.1	92	12.0	56	25

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
	48,032	17,134	9,050	35.7	53	18.8	3,717	173

* unaudited

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Key credit portfolios*: Ulster Bank Group (Core and Non-Core) continued

2010	Gross loans £m	REIL £m	Provisions £m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % of gross loans %	Impairment charge £m	Amounts written-off £m
Core								
Mortgages	21,162	1,566	439	7.4	28	2.1	294	7
Personal unsecured	1,282	185	158	14.4	85	12.3	48	30
Commercial real estate								
- investment	4,284	598	332	14.0	56	7.7	259	—
- development	1,090	65	37	6.0	57	3.4	116	—
Other corporate	9,039	1,205	667	13.3	55	7.4	444	11
	36,857	3,619	1,633	9.8	45	4.4	1,161	48
Non-Core								
Mortgages	—	—	—	—	—	—	42	—
Commercial real estate								
- investment	3,854	2,391	1,000	62.0	42	25.9	630	—
- development	8,760	6,341	2,783	72.4	44	31.8	1,759	—
Other corporate	1,970	1,310	561	66.5	43	28.5	251	—
	14,584	10,042	4,344	68.9	43	29.8	2,682	—
Ulster Bank Group								
Mortgages	21,162	1,566	439	7.4	28	2.1	336	7
Personal unsecured	1,282	185	158	14.4	85	12.3	48	30
Commercial real estate								
- investment	8,138	2,989	1,332	36.7	45	16.4	889	—
- development	9,850	6,406	2,820	65.0	44	28.6	1,875	—
Other corporate	11,009	2,515	1,228	22.8	49	11.2	695	11
	51,441	13,661	5,977	26.6	44	11.6	3,843	48
2009								
Core								
Mortgages	16,199	558	102	3.4	18	0.6	74	3
Personal unsecured	2,433	174	145	7.2	83	6.0	66	27
Commercial real estate								
- investment	6,131	250	105	4.1	42	1.7	84	—
- development	3,838	428	284	11.2	66	7.4	221	4
Other corporate	11,106	850	326	7.7	38	2.9	204	—

	39,707	2,260	962	5.7	43	2.4	649	34
Non-Core								
Mortgages	6,002	324	51	5.4	16	0.8	42	—
Commercial real estate								
- investment	2,061	1,498	308	72.7	21	14.9	286	—
- development	6,271	3,840	822	61.2	21	13.1	732	—
Other corporate	1,373	1,126	322	82.0	29	23.5	217	—
	15,707	6,788	1,503	43.2	22	9.6	1,277	—
Ulster Bank Group								
Mortgages	22,201	882	153	4.0	17	0.7	116	3
Personal unsecured	2,433	174	145	7.2	83	6.0	66	27
Commercial real estate								
- investment	8,192	1,748	413	21.3	24	5.0	370	—
- development	10,109	4,268	1,106	42.2	26	10.9	953	4
Other corporate	12,479	1,976	648	15.8	33	5.2	421	—
	55,414	9,048	2,465	16.3	27	4.4	1,926	34

* unaudited

Key points

- REIL increased by £3.5 billion during the year, which reflects continuing difficult conditions in both the commercial and residential sectors in Ireland. Growth moderated in the last two quarters of 2011 as default trends for corporate portfolios declined.

- At 31 December 2011, 68% of REIL was in Non-Core (2010 - 74%; 2009 - 75%). The majority of the Non-Core commercial real estate development portfolio (89%) is REIL with a 57% provision coverage.

Residential mortgages

The tables below show how the continued decrease in property values has affected the distribution of residential mortgages by indexed LTV. LTV is based upon gross loan amounts and whilst including defaulted loans, does not take account of provisions made.

	2011	2010	2009
LTV distribution calculated on a volume basis*	%	%	%
<= 70%	45.0	50.3	59.2
> 70% and <= 90%	11.4	13.0	12.0
> 90% and <= 110%	12.0	14.5	13.4
> 110% and <= 130%	10.9	13.5	11.3
> 130%	20.7	8.7	4.1
Total portfolio average LTV at 31 December	81.0	71.2	62.5
Average LTV on new originations during the year	67.0	75.9	72.8

	2011	2010	2009
LTV distribution calculated on a value basis	£m	£m	£m
<= 70%	4,526	5,928	7,393
> 70% and <= 90%	2,501	3,291	3,830
> 90% and <= 110%	3,086	4,256	4,907
> 110% and <= 130%	3,072	4,391	4,491
> 130%	6,517	2,958	1,681
Total portfolio average LTV at 31 December	106.1%	91.7%	86.2%
Average LTV on new originations during the year	73.9%	78.9%	78.5%

Key points

- The residential mortgage portfolio across Ulster Bank Group totalled £20 billion at 31 December 2011, with 89% in the Republic of Ireland and 11% in Northern Ireland.

- The mortgage REIL continued to increase as a result of the continued challenging economic environment. At 31 December 2011, REIL as a percentage of gross mortgages was 10.9% (by value) compared with 7.4% in 2010. The impairment charge for 2011 was £570 million compared with £336 million for 2010. Repossession levels were higher than in 2010, with a total of 161 properties repossessed during 2011 (compared with 76 during 2010). 76% of repossessions during 2011 were through voluntary surrender or abandonment of the property.

- Ulster Bank is assisting customers in this difficult environment. Mortgage forbearance policies which are deployed through the Flex' initiative are aimed at assisting customers in financial difficulty. At 31 December 2011, 9.1% (by value) of the mortgage book (£1.8 billion) was on a forbearance arrangement compared with 5.8% (£1.2 billion) at 31 December 2010. The majority of these forbearance arrangements are in the performing book (77%) and not 90 days past due.

* unaudited

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Business review Risk and balance sheet management continued

Risk management: Credit risk continued

Key credit portfolios*: Ulster Bank Group (Core and Non-Core) continued

Commercial real estate

The commercial real estate lending portfolio for Ulster Bank Group totalled £17.1 billion at 31 December 2011, of which £12.3 billion or 72% is Non-Core. The geographic split of the total Ulster Bank Group commercial real estate portfolio remained similar to 2010, with 26% in Northern Ireland, 63% in the Republic of Ireland and 11% in the UK.

	Development		Investment		
	Commercial	Residential	Commercial	Residential	Total
Exposure by geography	£m	£m	£m	£m	£m
2011					
Ireland (ROI & NI)	2,591	6,317	5,097	1,132	15,137
UK (excluding NI)	95	336	1,371	111	1,913
RoW	—	32	27	4	63
	2,686	6,685	6,495	1,247	17,113
2010					
Ireland (ROI & NI)	2,785	6,578	5,032	1,098	15,493
UK (excluding NI)	110	359	1,869	115	2,453
RoW	—	18	23	1	42
	2,895	6,955	6,924	1,214	17,988
2009					
Ireland (ROI & NI)	3,075	5,961	5,314	1,031	15,381
UK (excluding NI)	217	849	1,692	132	2,890
RoW	—	7	20	3	30
	3,292	6,817	7,026	1,166	18,301

Key points

- Commercial real estate remains the primary driver of the increase in the defaulted loan book for Ulster Bank Group. The outlook remains challenging, with limited liquidity in the marketplace to support sales or refinancing. The decrease in asset valuations has placed pressure on the portfolio.

- Within its early problem management framework, Ulster Bank may agree various remedial measures with customers whose loans are performing but who are experiencing temporary financial difficulties. During 2011, commercial real estate loans amounting to £0.8 billion (exposures greater than £10 million) benefited from such measures.

- During 2011, impaired commercial real estate loans amounting to £1 billion (exposures greater than £10 million) were restructured and remain in the non-performing book.

* unaudited

Balance sheet analysis
All the disclosures in this section (pages 119 to 186) are audited unless otherwise indicated by an asterisk (*).

The following tables provide an analysis of credit concentration of financial assets by sector, geography and internal credit quality gradings. Credit risk assets analysed on the pages 102 to 107 are reported internally to senior management. However, they exclude certain exposures, primarily securities, and take account of legal netting agreements, that provide a right of legal set-off but do not meet the criteria for offset in IFRS. The analysis below is therefore provided to supplement the credit risk assets analysis and to reconcile to the consolidated balance sheet.

Credit concentration: Sector and geographical region
The tables on pages 119 to 128 analyse total financial assets gross of provisions by sector (for Group before RFS MI) and geographical region (for Group before RFS MI and RFS MI). Geographical regions are based on the location of the lending or issuing office.

The tables below and on pages 120 and 121 analyse total financial assets by sector.

		Loans and advances			Securities						Netting and offset
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	(2) £m
Central and local government	2,247	8,359	1,383	9,742	126,604	328	126,932	5,541	641	145,103	1,098
Finance - banks	39,345	43,374	619	43,993	16,940	—	16,940	—	79,269	179,547	18,693
- other (3)	58,478	46,452	3,229	49,681	60,453	5,618	66,071	497,993	7,437	679,660	508,481
Residential mortgages	—	138,509	5,102	143,611	—	—	—	48	—	143,659	—
Personal lending	—	31,067	1,556	32,623	—	—	—	52	52	32,727	7
Property	—	38,704	38,064	76,768	573	175	748	4,599	1	82,116	1,274
Construction	—	6,781	2,672	9,453	50	53	103	946	—	10,502	1,139
Manufacturing	254	23,201	4,931	28,132	664	1,938	2,602	3,786	306	35,080	2,214
Service industries and business activities											
- retail, wholesale and repairs	—	21,314	2,339	23,653	645	2,652	3,297	1,134	18	28,102	1,671
- transport and storage	436	16,454	5,477	21,931	539	74	613	3,759	—	26,739	241
- health, education and recreation	—	13,273	1,419	14,692	310	21	331	885	—	15,908	973
	—	7,143	1,161	8,304	116	5	121	671	—	9,096	184

- hotels and restaurants											
- utilities	—	6,543	1,849	8,392	1,530	554	2,084	3,708	30	14,214	450
- other	23	24,228	3,772	28,000	1,655	3,893	5,548	6,300	595	40,466	855
Agriculture, forestry and fishing	—	3,471	129	3,600	25	11	36	121	—	3,757	148
Finance lease and instalment credit	—	8,440	6,059	14,499	145	2	147	75	—	14,721	16
Interest accruals	151	675	116	791	1,219	—	1,219	—	—	2,161	-
Total gross of provisions	100,934	437,988	79,877	517,865	211,468	15,324	226,792	529,618	88,349	1,463,558	537,444
Provisions	—	(8,414)	(11,469)	(19,883)	(2,388)	(141)	(2,529)	—	—	(22,412)	n/a
Group	100,934	429,574	68,408	497,982	209,080	15,183	224,263	529,618	88,349	1,441,146	537,444
Comprising:											
Repurchase agreements											15,246
Derivative balances											478,848
Derivative collateral											31,368
Other											11,982
											537,444

For notes relating to this table refer to page 128.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Credit concentration: Sector and geographical region continued

		Loans and advances			Securities						Netting and offset
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	(2) £m
Central and local government	645	6,781	1,671	8,452	130,123	767	130,890	7,560	291	147,838	3,916
Finance - banks	42,571	57,033	1,003	58,036	22,474	—	22,474	—	57,014	180,095	24,673
- other (3)	51,297	46,910	7,651	54,561	54,726	19,562	74,288	399,318	12,185	591,649	378,714
Residential mortgages	—	140,359	6,142	146,501	—	—	—	6	—	146,507	19
Personal lending	—	33,581	3,891	37,472	63	—	63	15	48	37,598	11
Property	—	42,455	47,651	90,106	2,700	237	2,937	3,830	28	96,901	1,046
Construction	—	8,680	3,352	12,032	56	31	87	780	—	12,899	1,406
Manufacturing	389	25,797	6,520	32,317	784	113	897	3,229	—	36,832	2,156
Service industries and business activities											
- retail, wholesale and repairs	—	21,974	3,191	25,165	520	41	561	1,124	—	26,850	2,468
- transport and storage	—	15,946	8,195	24,141	879	54	933	2,703	—	27,777	224
- health, education and recreation	—	17,456	1,865	19,321	1,495	42	1,537	1,198	—	22,056	1,047
- hotels and restaurants	—	8,189	1,492	9,681	276	123	399	525	—	10,605	253
- utilities	—	7,098	2,110	9,208	1,714	229	1,943	2,491	2	13,644	985
- other	126	24,464	5,530	29,994	1,532	1,172	2,704	4,244	386	37,454	1,378
Agriculture, forestry and fishing	—	3,758	135	3,893	28	1	29	40	—	3,962	115
Finance lease and instalment credit	—	8,321	8,529	16,850	13	2	15	14	—	16,879	134
Interest accruals	91	831	278	1,109	1,398	—	1,398	—	—	2,598	—

Total gross of provisions	95,119	469,633	109,206	578,839	218,781	28,374	241,155	427,077	69,954	1,412,144	418,545	9
Provisions	—	(7,866)	(10,316)	(18,182)	(1,301)	(176)	(1,477)	—	(29)	(19,688)	n/a	(
Group before RFS MI	95,119	461,767	98,890	560,657	217,480	22,198	239,678	427,077	69,925	1,392,456	418,545	9
RFS MI gross of provisions	—	—	—	2	—	—	—	—	—	2	—	
Group	95,119	461,767	98,890	560,659	217,480	22,198	239,678	427,077	69,925	1,392,458	418,545	9
Comprising:												
Repurchase agreements											10,712	
Derivative balances											361,493	
Derivative collateral											31,015	
Other											15,325	
											418,545	

For notes relating to this table refer to page 128.

		Loans and advances				Securities						Netting and offset	
2009	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	(2) £m	
Central and local government	260	6,128	1,532	7,660	142,032	780	142,812	6,998	205	157,935	1,725	1
Finance - banks	34,698	47,574	1,360	48,934	24,550	—	24,550	—	52,261	160,443	2,546	1
- other (3)	40,188	50,673	9,713	60,386	68,824	6,627	75,451	409,452	12,110	597,587	369,797	2
Residential mortgages	—	127,975	12,932	140,907	—	—	—	11	—	140,918	7	1
Personal lending	—	35,313	6,358	41,671	1	—	1	38	40	41,750	21	
Property	—	49,054	50,372	99,426	4,028	469	4,497	4,184	108	108,215	1,114	1
Construction	—	9,502	5,258	14,760	295	320	615	923	63	16,361	1,450	
Manufacturing	182	30,272	14,402	44,674	878	1,076	1,954	5,353	116	52,279	3,184	
Service industries and business activities												
- retail, wholesale and repairs	—	23,385	5,082	28,467	602	283	885	996	29	30,377	2,550	
- transport and storage	—	16,693	8,812	25,505	607	198	805	1,820	17	28,147	201	
- health, education and recreation	22	18,797	3,743	22,540	2,055	188	2,243	1,300	—	26,105	1,057	
- hotels and restaurants	—	9,699	1,710	11,409	418	595	1,013	832	90	13,344	284	
- utilities	—	6,772	3,106	9,878	1,298	2,379	3,677	2,613	296	16,464	445	
- other	293	25,092	11,185	36,277	2,814	3,082	5,896	3,619	362	46,447	1,274	
Agriculture, forestry and fishing	—	3,726	553	4,279	44	210	254	44	9	4,586	76	
Finance lease and instalment credit	—	8,147	11,956	20,103	291	15	306	16	—	20,425	39	
Interest accruals	494	1,179	549	1,728	1,571	—	1,571	—	—	3,793	—	
Total gross of provisions	76,137	469,981	148,623	618,604	250,308	16,222	266,530	438,199	65,706	1,465,176	385,770	1,0
Provisions	—	(6,921)	(8,252)	(15,173)	(1,198)	(277)	(1,475)	—	—	(16,648)	n/a	(
Group before RFS MI	76,137	463,060	140,371	603,431	249,110	15,945	265,055	438,199	65,706	1,448,528	385,770	1,0

RFS MI gross of provisions	—	—	—	142,688	18,144	3,586	21,730	3,255	9	167,682	55	1
RFS MI provision	—	—	—	(2,110)	—	(3)	(3)	—	—	(2,113)	n/a	
Group	76,137	463,060	140,371	744,009	267,254	19,528	286,782	441,454	65,715	1,614,097	385,825	1,2

For notes relating to this table refer to page 128.

Key points

- Financial assets, after taking account of netting and offset arrangements, decreased from £974 billion at 2010 to £903 billion at 2011 (£923 billion including disposal groups), principally reflecting reductions in loans and advances, including planned reductions of £29 billion in Non-Core reflecting disposal strategy as well as reductions in securities. Debt securities declined by £8 billion reflecting lower government and financial institution bond holdings. Equity shares decreased by £7 billion reflecting closure of Markets' global index and emerging markets positions in order to mitigate the potential impact of unfavourable market conditions.

- In terms of sector concentration, 37% of net financial assets related to financial institutions, including central banks, down from 38% in 2010. However, overall balances increased, principally reflecting higher central bank deposits in the Group's liquidity portfolio.

- Central and local government assets represented 16% of total financial assets, broadly unchanged from 2010, predominantly reflecting the Group's government bond holdings, most of which are issued by G10 governments, despite a reduction in holdings in both Group Treasury and Markets.

- Personal sector lending (residential mortgages and other lending) remained broadly flat.

- Commercial and other property related lending declined from £102.1 billion to £86.2 billion, including disposal groups (£4.7 billion). The decline was driven by Non-Core reductions.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Credit concentration: Sector and geographical region continued

Loans and advances to banks and customers by geographical region
The table below analyses loans and advances, including reverse repos, gross of provisions by geographical region (location of office).

	2011 £m	2010 £m	2009 £m
Loans and advances to banks (1)			
- UK	55,061	70,400	59,348
- US	7,976	9,810	8,537
- Europe	8,865	10,655	5,535
- RoW	11,531	9,778	10,611
Group before RFS MI	83,433	100,643	84,031
RFS MI	—	2	7,879
	83,433	100,645	91,910
Loans and advances to customers			
- UK	351,147	374,822	386,798
- US	90,329	90,752	93,209
- Europe	74,045	83,586	102,571
- RoW	19,845	24,155	28,132
Group before RFS MI	535,366	573,315	610,710
RFS MI	—	—	134,809
	535,366	573,315	745,519
Group before RFS MI	618,799	673,958	694,741
RFS MI	—	2	142,688
Group	618,799	673,960	837,429

Note:
(1) Loans and advances to banks includes £95 million of accrued interest (2010 - £36 million; 2009 - £339 million).

Key points

- Gross loans and advances declined by £55.2 billion during 2011 of which £19.4 billion related to the transfer to disposal groups.

- Customer lending declined £37.9 billion, principally reflecting the transfer to disposal groups and the Non-Core disposal strategy:
  - UK down £23.7 billion;
  - US down £0.4 billion;
  - Europe down £9.5 billion; and
  - Rest of the World down £4.3 billion.

The tables on pages 123 to 128 analyse financial assets by geographical region (location of office) and sector.

	Loans and advances				Securities						
2011	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
UK											
Central and local government	2,130	8,012	25	8,037	78,892	8	78,900	5,282	548	94,897	1,098
Finance - banks	25,204	29,575	207	29,782	1,950	—	1,950	—	40,365	97,301	18,653
- other (3)	39,154	30,874	2,361	33,235	25,779	4,462	30,241	301,125	3,259	407,014	312,007
Residential mortgages	—	99,303	1,423	100,726	—	—	—	48	—	100,774	
Personal lending	—	20,080	127	20,207	—	—	—	51	24	20,282	7
Property	—	31,141	24,610	55,751	278	137	415	4,332	—	60,498	1,265
Construction	—	5,291	1,882	7,173	20	26	46	895	—	8,114	1,115
Manufacturing	254	9,641	835	10,476	499	1,908	2,407	2,259	—	15,396	2,205
Service industries and business activities											
- retail, wholesale and repairs	—	11,071	1,441	12,512	574	2,616	3,190	952	18	16,672	1,647
- transport and storage	436	8,589	3,439	12,028	145	67	212	2,217	—	14,893	200
- health, education and recreation	—	8,734	757	9,491	72	8	80	756	—	10,327	965
- hotels and restaurants	—	5,599	569	6,168	23	—	23	664	—	6,855	178
- utilities	—	2,462	922	3,384	1,150	513	1,663	3,207	30	8,284	450
- other	—	13,963	1,644	15,607	1,017	3,459	4,476	3,988	593	24,664	830
Agriculture, forestry and fishing	—	2,660	76	2,736	18	10	28	111	—	2,875	117
Finance lease and instalment credit	—	5,618	5,598	11,216	1	2	3	73	—	11,292	16
Interest accruals	126	375	—	375	474	—	474	—	—	975	
Group	67,304	292,988	45,916	338,904	110,892	13,216	124,108	325,960	44,837	901,113	340,753
US											
	—	177	14	191	22,936	317	23,253	9	1	23,454	

Central and local government											
Finance - banks	7,289	671	15	686	1,245	—	1,245	—	29,426	38,646	15
- other (3)	17,368	8,993	341	9,334	29,885	681	30,566	165,879	3,496	226,643	168,601
Residential mortgages	—	20,311	2,926	23,237	—	—	—	—	—	23,237	
Personal lending	—	7,505	936	8,441	—	—	—	—	—	8,441	
Property	—	2,413	1,370	3,783	26	23	49	38	—	3,870	
Construction	—	412	45	457	21	3	24	11	—	492	
Manufacturing	—	6,782	42	6,824	101	12	113	452	—	7,389	
Service industries and business activities											
- retail, wholesale and repairs	—	4,975	98	5,073	52	—	52	63	—	5,188	
- transport and storage	—	1,832	937	2,769	26	1	27	1,084	—	3,880	
- health, education and recreation	—	2,946	88	3,034	74	4	78	93	—	3,205	
- hotels and restaurants	—	627	57	684	93	3	96	1	—	781	
- utilities	—	1,033	28	1,061	243	16	259	322	—	1,642	
- other	23	4,927	394	5,321	429	105	534	1,421	—	7,299	
Agriculture, forestry and fishing	—	27	—	27	7	—	7	6	—	40	
Finance lease and instalment credit	—	2,471	—	2,471	17	—	17	—	—	2,488	
Interest accruals	6	181	45	226	259	—	259	—	—	491	
Group	24,686	66,283	7,336	73,619	55,414	1,165	56,579	169,379	32,923	357,186	168,616

For notes relating to this table refer to page 128.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Credit concentration: Sector and geographical region continued

2011	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	
Europe												
Central and local government	—	116	715	831	13,362	3	13,365	60	—	14,256	—	14,
Finance - banks	247	8,361	250	8,611	10,859	—	10,859	—	6,701	26,418	—	26,
- other (3)	—	2,534	474	3,008	4,521	240	4,761	289	90	8,148	1	8,
Residential mortgages	—	18,393	553	18,946	—	—	—	—	—	18,946	—	18,
Personal lending	—	1,972	492	2,464	—	—	—	—	28	2,492	—	2,
Property	—	4,846	11,538	16,384	—	—	—	168	—	16,552	9	16,
Construction	—	1,019	735	1,754	—	22	22	18	—	1,794	24	1,
Manufacturing	—	4,383	3,732	8,115	57	5	62	23	—	8,200	9	8,
Service industries and business activities												
- retail, wholesale and repairs	—	3,992	772	4,764	16	2	18	23	—	4,805	24	4,
- transport and storage	—	5,667	862	6,529	143	—	143	15	—	6,687	6	6,
- health, education and recreation	—	1,235	349	1,584	164	5	169	2	—	1,755	8	1,
- hotels and restaurants	—	892	535	1,427	—	—	—	6	—	1,433	6	1,
- utilities	—	1,569	530	2,099	124	3	127	85	—	2,311	—	2,
- other	—	2,966	1,555	4,521	131	70	201	34	—	4,756	25	4,
Agriculture, forestry and fishing	—	699	53	752	—	1	1	1	—	754	31	
Finance lease and instalment credit	—	260	435	695	—	—	—	—	—	695	—	
Interest accruals	7	101	71	172	437	—	437	—	—	616	—	

Group	254	59,005	23,651	82,656	29,814	351	30,165	724	6,819	120,618	143	120,
RoW												
Central and local government	117	54	629	683	11,414	—	11,414	190	92	12,496	—	12,
Finance - banks	6,605	4,767	147	4,914	2,886	—	2,886	—	2,777	17,182	25	17,
- other (3)	1,956	4,051	53	4,104	268	235	503	30,700	592	37,855	27,872	9,
Residential mortgages	—	502	200	702	—	—	—	—	—	702	—	
Personal lending	—	1,510	1	1,511	—	—	—	1	—	1,512	—	1,
Property	—	304	546	850	269	15	284	61	1	1,196	—	1,
Construction	—	59	10	69	9	2	11	22	—	102	—	
Manufacturing	—	2,395	322	2,717	7	13	20	1,052	306	4,095	—	4,
Service industries and business activities												
- retail, wholesale and repairs	—	1,276	28	1,304	3	34	37	96	—	1,437	—	1,
- transport and storage	—	366	239	605	225	6	231	443	—	1,279	35	1,
- health, education and recreation	—	358	225	583	—	4	4	34	—	621	—	
- hotels and restaurants	—	25	—	25	—	2	2	—	—	27	—	
- utilities	—	1,479	369	1,848	13	22	35	94	—	1,977	—	1,
- other	—	2,372	179	2,551	78	259	337	857	2	3,747	—	3,
Agriculture, forestry and fishing	—	85	—	85	—	—	—	3	—	88	—	
Finance lease and instalment credit	—	91	26	117	127	—	127	2	—	246	—	
Interest accruals	12	18	—	18	49	—	49	—	—	79	—	
Group	8,690	19,712	2,974	22,686	15,348	592	15,940	33,555	3,770	84,641	27,932	56,

For notes relating to this table refer to page 128.

2010	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netti an offset (£
UK											
Central and local government	611	5,728	173	5,901	72,427	1	72,428	7,300	173	86,413	3,91
Finance - banks	28,370	41,541	481	42,022	5,381	—	5,381	—	28,097	103,870	24,48
- other (3)	33,186	27,995	6,023	34,018	27,737	18,645	46,382	249,324	5,390	368,300	232,46
Residential mortgages	—	99,928	1,665	101,593	—	—	—	6	—	101,599	1
Personal lending	—	23,035	585	23,620	1	—	1	9	23	23,653	1
Property	—	34,970	30,492	65,462	2,302	175	2,477	3,739	28	71,706	1,04
Construction	—	7,041	2,310	9,351	39	—	39	741	—	10,131	1,39
Manufacturing	389	12,300	1,510	13,810	354	—	354	2,159	—	16,712	2,15
Service industries and business activities											
- retail, wholesale and repairs	—	12,554	1,853	14,407	343	11	354	874	—	15,635	2,45
- transport and storage	—	8,105	5,015	13,120	241	3	244	1,573	—	14,937	21
- health, education and recreation	—	13,502	1,039	14,541	160	22	182	877	—	15,600	1,04
- hotels and restaurants	—	6,558	808	7,366	172	—	172	518	—	8,056	24
- utilities	—	3,101	1,035	4,136	1,040	5	1,045	2,112	2	7,295	98
- other	1	14,445	1,991	16,436	549	447	996	1,986	335	19,754	1,35
Agriculture, forestry and fishing	—	2,872	67	2,939	—	—	—	35	—	2,974	9
Finance lease and instalment credit	—	5,589	7,785	13,374	13	2	15	14	—	13,403	13
Interest accruals	56	415	98	513	501	—	501	—	—	1,070	
Group	62,613	319,679	62,930	382,609	111,260	19,311	130,571	271,267	34,048	881,108	272,00
US											
Central and local government	—	263	53	316	24,975	766	25,741	5	112	26,174	

Finance - banks	8,978	820	12	832	1,951	—	1,951	—	19,455	31,216	18
- other (3)	16,023	9,522	587	10,109	21,958	126	22,084	121,717	4,950	174,883	123,67
Residential mortgages	—	20,548	3,653	24,201	—	—	—	—	—	24,201	
Personal lending	—	6,816	2,704	9,520	—	—	—	—	—	9,520	
Property	—	1,611	3,318	4,929	95	4	99	23	—	5,051	
Construction	—	442	78	520	5	—	5	16	—	541	
Manufacturing	—	5,459	143	5,602	412	22	434	583	—	6,619	
Service industries and business activities											
- retail, wholesale and repairs	—	4,264	237	4,501	132	—	132	68	—	4,701	
- transport and storage	—	1,786	1,408	3,194	99	2	101	929	—	4,224	
- health, education and recreation	—	2,380	313	2,693	1,308	3	1,311	292	—	4,296	
- hotels and restaurants	—	486	136	622	104	—	104	3	—	729	
- utilities	—	1,117	53	1,170	567	2	569	272	—	2,011	
- other	124	4,042	577	4,619	789	279	1,068	1,200	42	7,053	
Agriculture, forestry and fishing	—	31	—	31	28	—	28	3	—	62	
Finance lease and instalment credit	—	2,315	—	2,315	—	—	—	—	—	2,315	
Interest accruals	7	183	73	256	240	—	240	—	—	503	
Group	25,132	62,085	13,345	75,430	52,663	1,204	53,867	125,111	24,559	304,099	123,86

For notes relating to this table refer to page 128.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Credit concentration: Sector and geographical region continued

	Loans and advances				Securities							
2010	Reverse repos £m	Core £m	Non-Core £m	Total £m	Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	
Europe												
Central and local government	—	365	1,017	1,382	18,648	—	18,648	66	—	20,096	—	20,
Finance - banks	94	10,219	313	10,532	11,843	—	11,843	—	7,936	30,405	—	30,
- other (3)	—	2,642	1,019	3,661	4,886	347	5,233	746	53	9,693	1	9,
Residential mortgages	—	19,473	621	20,094	—	—	—	—	—	20,094	5	20,
Personal lending	—	2,270	600	2,870	62	—	62	—	25	2,957	—	2,
Property	—	5,139	12,636	17,775	—	43	43	—	—	17,818	5	17,
Construction	—	1,014	873	1,887	—	27	27	1	—	1,915	14	1,
Manufacturing	—	5,853	4,181	10,034	18	87	105	39	—	10,178	6	10,
Service industries and business activities												
- retail, wholesale and repairs	—	4,126	999	5,125	32	2	34	33	—	5,192	15	5,
- transport and storage	—	5,625	1,369	6,994	141	22	163	2	—	7,159	5	7,
- health, education and recreation	—	1,442	496	1,938	27	9	36	—	—	1,974	—	1,
- hotels and restaurants	—	1,055	535	1,590	—	120	120	—	—	1,710	4	1,
- utilities	—	1,412	623	2,035	74	188	262	10	—	2,307	—	2,
- other	—	3,877	2,050	5,927	109	176	285	54	1	6,267	23	6,
Agriculture, forestry and fishing	—	849	68	917	—	1	1	—	—	918	21	
Finance lease and instalment credit	—	370	744	1,114	—	—	—	—	—	1,114	—	1,
Interest accruals	28	143	101	244	575	—	575	—	—	847	—	
	122	65,874	28,245	94,119	36,415	1,022	37,437	951	8,015	140,644	99	140,

Group before RFS MI												
RFS MI	—	—	—	2	—	—	—	—	—	2	—	
Group	122	65,874	28,245	94,121	36,415	1,022	37,437	951	8,015	140,646	99	140,
RoW												
Central and local government	34	425	428	853	14,073	—	14,073	189	6	15,155	—	15,
Finance - banks	5,129	4,453	197	4,650	3,299	—	3,299	—	1,526	14,604	—	14,
- other (3)	2,088	6,751	22	6,773	145	444	589	27,531	1,792	38,773	22,575	16,
Residential mortgages	—	410	203	613	—	—	—	—	—	613	—	
Personal lending	—	1,460	2	1,462	—	—	—	6	—	1,468	—	1,
Property	—	735	1,205	1,940	303	15	318	68	—	2,326	—	2,
Construction	—	183	91	274	12	4	16	22	—	312	—	
Manufacturing	—	2,185	686	2,871	—	4	4	448	—	3,323	—	3,
Service industries and business activities												
- retail, wholesale and repairs	—	1,030	102	1,132	13	28	41	149	—	1,322	1	1,
- transport and storage	—	430	403	833	398	27	425	199	—	1,457	—	1,
- health, education and recreation	—	132	17	149	—	8	8	29	—	186	—	
- hotels and restaurants	—	90	13	103	—	3	3	4	—	110	—	
- utilities	—	1,468	399	1,867	33	34	67	97	—	2,031	—	2,
- other	1	2,100	912	3,012	85	270	355	1,004	8	4,380	1	4,
Agriculture, forestry and fishing	—	6	—	6	—	—	—	2	—	8	—	
Finance lease and instalment credit	—	47	—	47	—	—	—	—	—	47	—	
Interest accruals	—	90	6	96	82	—	82	—	—	178	—	
Group	7,252	21,995	4,686	26,681	18,443	837	19,280	29,748	3,332	86,293	22,577	63,

For notes relating to this table refer to page 128.

2009	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m
UK											
Central and local government	129	4,353	276	4,629	79,662	1	79,663	6,752	4	91,177	1,725
Finance - banks	21,955	36,741	424	37,165	2,355	—	2,355	—	20,693	82,168	2,483
- other (3)	29,240	29,278	6,004	35,282	38,135	5,676	43,811	257,109	5,492	370,934	236,443
Residential mortgages	—	90,688	1,896	92,584	—	—	—	11	—	92,595	7
Personal lending	—	24,613	1,137	25,750	1	—	1	9	22	25,782	21
Property	—	36,407	35,387	71,794	3,303	458	3,761	4,086	104	79,745	1,114
Construction	—	6,964	3,640	10,604	48	306	354	849	62	11,869	1,450
Manufacturing	182	14,462	3,255	17,717	640	1,003	1,643	4,222	102	23,866	3,184
Service industries and business activities											
- retail, wholesale and repairs	—	13,412	2,672	16,084	445	263	708	819	29	17,640	2,549
- transport and storage	—	10,066	5,319	15,385	369	163	532	988	15	16,920	201
- health, education and recreation	22	15,551	1,225	16,776	303	164	467	1,005	—	18,270	1,057
- hotels and restaurants	—	7,575	1,033	8,608	320	573	893	824	86	10,411	284
- utilities	—	2,626	1,652	4,278	1,142	2,308	3,450	2,321	259	10,308	445
- other	—	13,516	3,964	17,480	1,608	2,621	4,229	1,892	353	23,954	1,274
Agriculture, forestry and fishing	—	2,946	138	3,084	43	209	252	39	9	3,384	76
Finance lease and instalment credit	—	5,343	10,843	16,186	291	3	294	16	—	16,496	39
Interest accruals	321	713	178	891	457	—	457	—	—	1,669	
Group before RFS MI	51,849	315,254	79,043	394,297	129,122	13,748	142,870	280,942	27,230	897,188	252,352
RFS MI	—	—	—	444	49	1	50	494	—	988	
Group	51,849	315,254	79,043	394,741	129,171	13,749	142,920	281,436	27,230	898,176	252,352

US

Central and local government	—	196	64	260	23,841	779	24,620	9	141	25,030	
Finance - banks	7,466	982	76	1,058	1,473	—	1,473	—	7,533	17,530	63
- other (3)	9,912	9,524	1,771	11,295	25,592	85	25,677	125,599	5,779	178,262	113,607
Residential mortgages	—	21,842	4,317	26,159	—	—	—	—	—	26,159	
Personal lending	—	7,373	3,599	10,972	—	—	—	—	—	10,972	
Property	—	1,498	3,788	5,286	56	—	56	30	—	5,372	
Construction	—	490	132	622	71	1	72	50	—	744	
Manufacturing	—	5,895	1,200	7,095	218	25	243	580	—	7,918	
Service industries and business activities											
- retail, wholesale and repairs	—	3,897	422	4,319	142	—	142	108	—	4,569	
- transport and storage	—	1,679	1,525	3,204	108	1	109	738	—	4,051	
- health, education and recreation	—	1,595	1,356	2,951	1,698	—	1,698	272	—	4,921	
- hotels and restaurants	—	772	88	860	98	—	98	7	—	965	
- utilities	—	1,178	46	1,224	113	—	113	204	—	1,541	
- other	280	4,957	1,068	6,025	944	216	1,160	1,157	—	8,622	
Agriculture, forestry and fishing	—	27	—	27	1	—	1	2	—	30	
Finance lease and instalment credit	—	2,417	—	2,417	—	—	—	—	—	2,417	
Interest accruals	16	204	94	298	334	—	334	—	—	648	
Group before RFS MI	17,674	64,526	19,546	84,072	54,689	1,107	55,796	128,756	13,453	299,751	113,670
RFS MI	—	—	—	360	—	—	—	—	—	360	
Group	17,674	64,526	19,546	84,432	54,689	1,107	55,796	128,756	13,453	300,111	113,670

For notes relating to this table refer to page 128.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Credit concentration: Sector and geographical region continued

2009	Reverse repos £m	Loans and advances Core £m	Non-Core £m	Total £m	Securities Debt £m	Equity £m	Total £m	Derivatives £m	Other (1) £m	Total £m	Netting and offset (2) £m	
Europe												
Central and local government	—	334	1,164	1,498	25,328	—	25,328	68	24	26,918	—	
Finance - banks	—	4,905	529	5,434	17,390	—	17,390	—	22,792	45,616	—	
- other (3)	189	4,095	905	5,000	5,097	426	5,523	1,699	43	12,454	—	
Residential mortgages	—	15,055	6,718	21,773	—	—	—	—	—	21,773	—	
Personal lending	—	1,877	1,009	2,886	—	—	—	—	17	2,903	—	
Property	—	10,812	9,417	20,229	—	1	1	17	4	20,251	—	
Construction	—	1,946	1,167	3,113	—	1	1	1	1	3,116	—	
Manufacturing	—	7,311	8,609	15,920	19	23	42	123	—	16,085	—	
Service industries and business activities												
- retail, wholesale and repairs	—	5,464	1,661	7,125	15	1	16	7	—	7,148	—	
- transport and storage	—	4,385	1,463	5,848	15	4	19	—	2	5,869	—	
- health, education and recreation	—	1,419	1,121	2,540	54	9	63	—	—	2,603	—	
- hotels and restaurants	—	1,221	568	1,789	—	19	19	—	4	1,812	—	
- utilities	—	1,816	786	2,602	4	30	34	6	37	2,679	—	
- other	12	4,783	4,284	9,067	156	24	180	75	8	9,342	—	
Agriculture, forestry and fishing	—	737	356	1,093	—	1	1	—	—	1,094	—	
Finance lease and instalment credit	—	379	1,094	1,473	—	12	12	—	—	1,485	—	
Interest accruals	102	168	245	413	706	—	706	—	—	1,221	—	
	303	66,707	41,096	107,803	48,784	551	49,335	1,996	22,932	182,369	—	1

Group before RFS MI												
RFS MI	—	—	—	140,098	21,681	3,232	24,913	165,020	—	330,031	—	3
Group	303	66,707	41,096	247,901	70,465	3,783	74,248	167,016	22,932	512,400	—	5
RoW												
Central and local government	131	1,245	28	1,273	13,201	—	13,201	169	36	14,810	—	
Finance - banks	5,277	4,946	331	5,277	3,332	—	3,332	—	1,243	15,129	—	
- other (3)	847	7,776	1,033	8,809	—	440	440	25,045	796	35,937	19,747	
Residential mortgages	—	390	1	391	—	—	—	—	—	391	—	
Personal lending	—	1,450	613	2,063	—	—	—	29	1	2,093	—	
Property	—	337	1,780	2,117	669	10	679	51	—	2,847	—	
Construction	—	102	319	421	176	12	188	23	—	632	—	
Manufacturing	—	2,604	1,338	3,942	1	25	26	428	14	4,410	—	
Service industries and business activities												
- retail, wholesale and repairs	—	612	327	939	—	19	19	62	—	1,020	1	
- transport and storage	—	563	505	1,068	115	30	145	94	—	1,307	—	
- health, education and recreation	—	232	41	273	—	15	15	23	—	311	—	
- hotels and restaurants	—	131	21	152	—	3	3	1	—	156	—	
- utilities	—	1,152	622	1,774	39	41	80	82	—	1,936	—	
- other	1	1,836	1,869	3,705	106	221	327	495	1	4,529	—	
Agriculture, forestry and fishing	—	16	59	75	—	—	—	3	—	78	—	
Finance lease and instalment credit	—	8	19	27	—	—	—	—	—	27	—	
Interest accruals	55	94	32	126	74	—	74	—	—	255	—	
Group before RFS MI	6,311	23,494	8,938	32,432	17,713	816	18,529	26,505	2,091	85,868	19,748	
RFS MI	—	—	—	1,786	—	22	22	1,808	—	3,616	—	
Group	6,311	23,494	8,938	34,218	17,713	838	18,551	28,313	2,091	89,484	19,748	

Notes:
(1)

Includes cash and balances at central banks of £79,269 million (2010 - £57,014 million; 2009 - £52,261 million) and settlement balances of £7,771 million (2010 - £11,605 million; 2009 - £12,033 million).

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

(3) Loans made by the Group's consolidated conduits to asset owning companies are included within Finance.

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, 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	Banks	Other	Total	Short positions	Net of short positions
2011	£m	£m	£m	£m	£m	£m
United States	20,932	7,300	38,721	66,953	13,329	53,624
Germany	34,615	5,952	9,787	50,354	2,946	47,408
France	11,633	14,800	8,189	34,622	5,903	28,719
Japan	8,350	7,505	3,375	19,230	3,141	16,089
Netherlands	4,466	2,210	10,711	17,387	982	16,405
Spain	340	3,656	10,282	14,278	973	13,305
Italy	5,190	548	1,489	7,227	4,826	2,401
Republic of Ireland	665	3,287	2,759	6,711	68	6,643
Switzerland	1,335	3,282	1,492	6,109	25	6,084
China	1,589	2,669	1,849	6,107	—	6,107
Cayman Islands	—	15	4,194	4,209	2	4,207
Belgium	1,662	1,285	1,222	4,169	726	3,443
2010						
United States	21,201	14,382	36,813	72,396	14,240	58,156
Germany	22,962	6,276	10,467	39,705	4,685	35,020
France	17,293	16,007	6,756	40,056	4,285	35,771
Japan	7,983	6,962	7,542	22,487	409	22,078
Netherlands	2,900	3,055	10,824	16,779	951	15,828
Spain	1,401	4,248	11,589	17,238	1,357	15,881
Italy	6,409	1,083	2,188	9,680	3,183	6,497
Republic of Ireland	199	3,789	3,101	7,089	131	6,958
Switzerland	4	1,714	2,944	4,662	12	4,650
China	553	1,775	1,561	3,889	5	3,884
Cayman Islands	2	94	7,330	7,426	44	7,382
Belgium	1,461	752	2,806	5,019	606	4,413

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis continued

Asset quality
The asset quality analysis presented below is based on the Group's internal asset quality ratings which have ranges for the probability of default as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across the Group map to both a Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings and are therefore excluded from the table below and are set out on pages 133 and 134.

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%

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Total									
AQ1	78,592	74,192	113,437	4,582	481,622	556	75,356	14,076	842,413
AQ2	342	1,881	15,622	93	8,177	—	24,269	3,154	53,538
AQ3	196	1,981	32,830	546	10,819	—	23,471	4,427	74,270
AQ4	19	1,612	103,617	760	14,421	—	40,071	5,847	166,347

AQ5	90	1,261	112,537	79	6,516	45	34,593	4,301	159,422
AQ6	9	188	47,892	46	2,221	—	17,153	1,662	69,171
AQ7	8	432	31,379	13	2,393	—	19,163	1,037	54,425
AQ8	7	30	11,871	19	1,252	—	4,159	276	17,614
AQ9	5	83	16,006	4	1,150	320	2,286	943	20,797
AQ10	1	164	570	6	1,047	—	2,354	221	4,363
Past due	—	2	10,995	1,623	—	—	—	—	12,620
Impaired	—	137	38,610	—	—	414	—	—	39,161
Impairment provision	—	(123)	(19,760)	—	—	(26)	—	—	(19,909)
Group	79,269	81,840	515,606	7,771	529,618	1,309	242,875	35,944	1,494,232
2010									
AQ1	56,655	91,952	126,444	6,815	408,489	658	78,728	9,745	779,486
AQ2	14	598	13,282	1,271	2,659	3	26,128	1,980	45,935
AQ3	48	2,197	25,981	156	3,317	—	25,731	4,337	61,767
AQ4	188	639	95,777	571	3,391	6	41,027	6,522	148,121
AQ5	99	2,322	114,796	64	4,860	144	38,612	5,169	166,066
AQ6	3	159	65,497	34	1,070	—	25,991	2,230	94,984
AQ7	2	178	46,072	1	857	69	18,752	2,456	68,387
AQ8	—	15	16,573	14	403	—	9,289	9,545	35,839
AQ9	—	115	14,263	2	450	80	3,889	932	19,731
AQ10	5	355	5,644	2	1,581	—	2,829	407	10,823
Accruing past due	—	10	13,430	2,675	—	—	—	—	16,115
Impaired	—	145	35,556	—	—	375	—	—	36,076
Impairment provision	—	(127)	(18,055)	—	—	(29)	—	—	(18,211)
Group before RFS MI	57,014	98,558	555,260	11,605	427,077	1,306	270,976	43,323	1,465,119
RFS MI	—	2	—	—	—	—	—	32	34
Group	57,014	98,560	555,260	11,605	427,077	1,306	270,976	43,355	1,465,153

For the note relating to this table refer to page 132.

2009	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
AQ1	51,521	72,384	106,062	6,582	389,019	754	62,085	9,446	697,853
AQ2	—	1,725	10,780	306	11,550	9	27,598	4,526	56,494
AQ3	1	2,175	29,958	199	10,791	—	28,364	6,088	77,576
AQ4	23	1,357	102,922	605	8,296	—	52,496	14,948	180,647
AQ5	2	2,497	124,724	149	8,270	37	43,239	7,387	186,305
AQ6	1	424	94,513	40	2,548	—	30,847	2,448	130,821
AQ7	—	110	46,928	33	2,181	98	26,724	2,352	78,426
AQ8	—	137	23,593	—	1,448	—	12,507	1,008	38,693
AQ9	—	184	16,025	—	2,030	—	5,141	1,279	24,659
AQ10	—	277	9,142	3	2,026	—	3,618	507	15,573
Accruing past due	—	36	14,475	3,910	40	—	—	—	18,461
Impaired	—	206	31,588	197	—	—	—	—	31,991
Impairment provision	—	(157)	(15,016)	—	—	—	—	—	(15,173)
Group before RFS MI	51,548	81,355	595,694	12,024	438,199	898	292,619	49,989	1,522,326
RFS MI	713	7,865	132,699	9	3,255	—	5,022	4,031	153,594
Group	52,261	89,220	728,393	12,033	441,454	898	297,641	54,020	1,675,920
2011									
Core									
AQ1	78,534	73,689	94,704	4,566	477,746	468	69,220	13,247	812,174
AQ2	342	1,877	13,970	91	7,500	—	23,404	3,122	50,306
AQ3	56	1,967	30,082	546	10,360	—	22,319	4,354	69,684
AQ4	18	1,557	97,001	759	13,475	—	38,808	5,655	157,273
AQ5	90	1,256	105,392	79	5,087	45	33,226	4,092	149,267
AQ6	9	140	41,476	46	1,987	—	16,118	1,634	61,410
AQ7	8	432	27,114	13	796	—	17,514	949	46,826
AQ8	7	20	9,857	19	666	—	4,068	236	14,873
AQ9	5	83	11,515	4	592	272	1,769	898	15,138
AQ10	1	164	264	6	339	—	1,274	180	2,228
Past due	—	2	9,451	1,623	—	—	—	—	11,076
Impaired	—	136	15,170	—	—	413	—	—	15,719
Impairment provision	—	(122)	(8,292)	—	—	(25)	—	—	(8,439)
Group	79,070	81,201	447,704	7,752	518,548	1,173	227,720	34,367	1,397,535
2010									
AQ1	56,637	91,298	103,645	6,814	396,419	366	71,091	9,651	735,921
AQ2	14	550	10,534	1,271	2,243	3	24,923	1,728	41,266

AQ3	48	2,165	22,851	155	3,132	—	23,546	4,268	56,165
AQ4	10	539	85,779	571	3,017	6	36,909	5,070	131,901
AQ5	99	2,247	100,051	64	3,988	15	35,302	4,924	146,690
AQ6	3	138	53,498	34	805	—	24,050	2,140	80,668
AQ7	2	154	38,438	1	595	69	17,605	2,309	59,173
AQ8	—	15	13,290	14	257	—	8,617	9,434	31,627
AQ9	—	107	9,898	2	237	50	3,442	886	14,622
AQ10	5	300	2,777	2	368	—	1,500	250	5,202
Past due	—	3	10,744	2,629	—	—	—	—	13,376
Impaired	—	144	13,367	—	—	375	—	—	13,886
Impairment provision	—	(126)	(7,740)	—	—	(29)	—	—	(7,895)
Group	56,818	97,534	457,132	11,557	411,061	855	246,985	40,660	1,322,602

For the note relating to this table refer to page 132.

Business review Risk and balance sheet management continued

Risk management: Credit risk continued
Balance sheet analysis: Asset quality continued

2011	Cash and balances at central banks £m	Loans and advances to banks (1) £m	Loans and advances to customers £m	Settlement balances £m	Derivatives £m	Other financial instruments £m	Commitments £m	Contingent liabilities £m	Total £m
Non-Core									
AQ1	58	503	18,733	16	3,876	88	6,136	829	30,239
AQ2	—	4	1,652	2	677	—	865	32	3,232
AQ3	140	14	2,748	—	459	—	1,152	73	4,586
AQ4	1	55	6,616	1	946	—	1,263	192	9,074
AQ5	—	5	7,145	—	1,429	—	1,367	209	10,155
AQ6	—	48	6,416	—	234	—	1,035	28	7,761
AQ7	—	—	4,265	—	1,597	—	1,649	88	7,599
AQ8	—	10	2,014	—	586	—	91	40	2,741
AQ9	—	—	4,491	—	558	48	517	45	5,659
AQ10	—	—	306	—	708	—	1,080	41	2,135
Accruing past due	—	—	1,544	—	—	—	—	—	1,544
Impaired	—	1	23,440	—	—	1	—	—	23,442
Impairment provision	—	(1)	(11,468)	—	—	(1)	—	—	(11,470)
Group	199	639	67,902	19	11,070	136	15,155	1,577	96,697
2010									
AQ1	18	654	22,799	1	12,070	292	7,637	94	43,565
AQ2	—	48	2,748	—	416	—	1,205	252	4,669
AQ3	—	32	3,130	1	185	—	2,185	69	5,602
AQ4	178	100	9,998	—	374	—	4,118	1,452	16,220
AQ5	—	75	14,745	—	872	129	3,310	245	19,376
AQ6	—	21	11,999	—	265	—	1,941	90	14,316
AQ7	—	24	7,634	—	262	—	1,147	147	9,214
AQ8	—	—	3,283	—	146	—	672	111	4,212
AQ9	—	8	4,365	—	213	30	447	46	5,109
AQ10	—	55	2,867	—	1,213	—	1,329	157	5,621
Accruing past due	—	7	2,686	46	—	—	—	—	2,739
Impaired	—	1	22,189	—	—	—	—	—	22,190
Impairment provision	—	(1)	(10,315)	—	—	—	—	—	(10,316)
Group before RFS MI	196	1,024	98,128	48	16,016	451	23,991	2,663	142,517

Note:
(1)

Excluding items in the course of collection from other banks of £1,470 million (2010 - £1,958 million; 2009 - £2,533 million).

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

	Central and local government								
	UK	US	Other	Banks	Other financial institutions	Corporate	Total	Total	Of which ABS (1)
2011	£m	£m	£m	£m	£m	£m	£m	%	£m
Total									
AAA	22,451	45	32,522	5,155	15,908	452	76,533	37	17,156
AA to AA+	—	40,435	2,000	2,497	30,403	639	75,974	36	33,615
A to AA-	—	1	24,966	6,387	4,979	1,746	38,079	18	6,331
BBB- to A-	—	—	2,194	2,287	2,916	1,446	8,843	4	4,480
Non-investment grade	—	—	924	575	5,042	1,275	7,816	4	4,492
Unrated	—	3	2	39	1,380	411	1,835	1	1,235
	22,451	40,484	62,608	16,940	60,628	5,969	209,080	100	67,309
Core									
AAA	22,112	45	32,489	4,601	13,245	448	72,940	37	14,534
AA to AA+	—	40,435	1,995	2,434	28,125	565	73,554	38	31,323
A to AA-	—	1	24,964	6,302	3,348	1,614	36,229	18	4,731
BBB- to A-	—	—	2,194	2,272	1,727	1,232	7,425	4	3,188
Non-investment grade	—	—	723	559	2,542	1,048	4,872	2	2,552
Unrated	—	3	1	25	821	260	1,110		