RBS Holdings N.V.
Form 20-F
March 23, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)
o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 1-14624

RBS Holdings N.V.
(Exact name of Registrant as specified in its charter)

The Netherlands
(Jurisdiction of incorporation)

Gustav Mahlerlaan 10, 1082 PP Amsterdam, The Netherlands
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Guarantee of 5.90% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust V	New York Stock Exchange*
Guarantee of 6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VI	New York Stock Exchange**
	New York Stock Exchange***

Guarantee of 6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VII	
5.90% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust V	New York Stock Exchange
6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VI	New York Stock Exchange
6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VII	New York Stock Exchange
RBS US Large Cap Trendpilot Exchange Traded Notes	NYSE Arca
RBS US Mid Cap Trendpilot Exchange Traded Notes	NYSE Arca
RBS Gold Trendpilot Exchange Traded Notes	NYSE Arca

* The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust V.
** The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VI.
*** The guarantee is not listed for trading, but is listed only in connection with the registration of the corresponding Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Trust VII.

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
None

Indicate the number of outstanding shares of each class of common stock of the close of the period covered by the annual report

(Title of each class)	(Number of outstanding shares)
Ordinary shares, par value €0.56 per share	3,306,843,332

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes x No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
o Yes x No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
o Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-Accelerated filer x

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

o U.S. GAAP
x International Financial Reporting Standards as issued by the International Accounting Standards Board
o Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.
o Item 17 o Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
o Yes x No

RBS Holdings N.V.
Annual Report and Accounts 2011

Annual Report and Accounts

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SEC Form 20-F cross reference

Chairman’s Statement

In January 2012, The Royal Bank of Scotland Group plc announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes will see the reorganisation of RBS Holdings N.V.’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 Royal Bank of Scotland Group plc’s strategy. Since the announcement RBS Holdings N.V has agreed the sale of the cash equities, corporate finance and sector advisory, corporate actions and transaction support services, corporate financing and risk solutions (CFRS), and equity capital markets businesses in the Netherlands to ABN AMRO Bank N.V. The sale is expected to close in the second quarter of 2012, subject to certain conditions, including obtaining approvals from regulators and our social partners.

On 19 April 2011, RBS Holdings N.V. announced its intention to transfer a substantial part of the business activities of The Royal Bank of Scotland N.V. (RBS N.V.) to The Royal Bank of Scotland plc (RBS plc) (the Proposed Transfers), subject, amongst other matters, to regulatory and other approvals, further tax and other analysis in respect of the assets and liabilities to be transferred and employee consultation procedures.

The Proposed Transfers will not result in any change to the current business strategy for any of the transferred RBS N.V. businesses and the way in which The Royal Bank of Scotland Group plc commercially operates will remain unchanged.

The Proposed Transfers are consistent with The Royal Bank of Scotland Group plc's efforts to simplify its structure, thereby reducing risk, cost and complexity. They will streamline the manner in which the businesses of the Group interact with clients with simplified access to the product suites.

It is expected that the Proposed Transfers will be implemented on a phased basis over a period ending 31 December 2013. The successful transfer of eligible business carried out in the UK, including certain securities issued by RBS N.V., was completed in the last quarter of 2011. Largely, as a result, the balance sheet of RBS Holdings N.V. has decreased from total assets of €200.4 billion as at 31 December 2010 to total assets of €146.7 billion as at 31 December 2011.

A large part of the remainder of Proposed Transfers (including the transfers of certain securities issued by RBS N.V.) is expected to have taken place by the end of 2012. As announced on 19 April 2011, The Royal Bank of Scotland Group plc is committed to providing the necessary support to ensure that RBS N.V. continues to meet its commitments during and after the Proposed Transfers.

Results of operations in 2011
2011 saw good progress in terms of risk reduction and financial soundness despite a much tougher market environment in which to achieve these goals. Customer service and support was sustained well.

However, RBS Holdings N.V. recorded a loss for the period of €0.7 billion. The loss resulted from significant non-operating items which occurred in 2011 including a gain of €1.3 billion on movements in the fair value of own debt, as the volatile market conditions led to a significant widening in RBS N.V.’s credit spreads during the second half of the year. This gain was more than offset by the impairment of Greek government bonds with a notional amount of €1.6 billion. For the year ended 31 December 2011, RBS Holdings N.V. recorded an impairment loss of €1.5 billion in respect of these bonds as a result of Greece’s continuing fiscal difficulties. This charge wrote the bonds down to their market price as at 31 December 2011. Net Interest income decreased in 2011 principally reflecting the significant changes in the structure of the balance sheet in the Non-Core segment and in Global Banking and Markets (GBM).

The decrease in Non-Core was largely as a result of the divestitures of operations in 2010. The decrease in GBM was largely due to transfers of businesses to RBS plc in 2011 as part of the Proposed Transfers. In addition, RBS Holdings N.V.'s margin was negatively affected by the cost of carrying higher liquidity reserves and central bank balances.

The profit from Non–interest income was due to a gain of €1.3 billion on movements in the fair value of own debt. This was partially offset by lower trading income in 2011 principally reflecting the significant changes in the structure of the balance sheet in Non-Core and GBM as discussed above. In addition lower results in GBM were seen, reflecting depressed primary market volumes and limited opportunities in the secondary market.

Impairments for 2011 amount to €1.8 billion, comprising an impairment charge of €1.5 billion on Greek bonds, as discussed above and commercial loan impairments of €0.3 billion. The loan impairment was largely driven by a single name impairment in 2011.

Total equity as at 31 December 2011 was €3.3 billion, a decrease of €1.6 billion compared to 31 December 2010.

RBS Holdings N.V. continued to be adequately capitalised. At 31 December 2011, the Group's Total capital ratio was 17.5%, the Tier 1 capital ratio was 12.0% and the Core Tier 1 capital ratio was 8.4%.

Outlook
Economic and regulatory challenges have continued into 2012. Growth prospects remain modest, while the eurozone sovereign crisis remains a risk. Against this backdrop, commercial performance is expected to remain broadly stable benefiting modestly from improvement in impairments. In GBM, revenue performance will remain market-dependent. The continuing run-off of Non-Core is expected to crystallise further disposal losses, though overall Non-Core losses are expected to fall. RBS Holdings N.V. expects to continue the further removal of risk through the Proposed Transfers, while maintaining adequate capital ratios.

On behalf of the Managing Board, I would like to thank all our employees and clients for their continued commitment during 2011.

Jan de Ruiter
Chairman of the Managing Board of RBS Holdings N.V.

Amsterdam, 22 March 2012

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In the Report and Accounts and unless specified otherwise, the terms 'company' and 'RBS Holdings' mean RBS Holdings N.V. RBS Holdings N.V. is the parent company of The Royal Bank of Scotland N.V. (RBS N.V.) consolidated group of companies and associated companies (RBSH Group). The Royal Bank of Scotland Group plc (RBSG) is the ultimate holding company of RBSH Group. RBSG Group refers to RBSG and its consolidated subsidiaries and associated companies. The terms 'Consortium' and 'Consortium Members' refer to RBSG, the Dutch State (successor to Fortis) and Banco Santander S.A. (Santander) who jointly acquired RBS Holdings on 17 October 2007 through RFS Holdings B.V. (RFS Holdings).

The company publishes its financial statements in 'euro', the European single currency. The abbreviations '€m' and '€bn' represent millions and thousands of millions of euros, respectively. Reference to '$' is to United States of America (US) dollars. The abbreviations '$m' and '$bn' represent millions and thousands of millions of dollars, respectively.

Certain information in this report is presented separately for domestic and foreign activities. Domestic activities consist of transactions within the Netherlands. Geographic analysis has been complied based on location of office.

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, any resulting misclassification is not material.

All annual averages in this report are based on month-end figures. Management does not believe that these month-end averages present trends materially different from those that would be presented by daily averages.

International Financial Reporting Standards
Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and IFRS as issued by the International Accounting Standard Board (IASB), which vary in certain significant respects from accounting principles generally accepted in the United States of America (USA), or 'US GAAP'.

Glossary
A glossary of terms is detailed on pages 246 to 252.

Certain sections in, or incorporated by reference in, this Annual Report and Accounts contain 'forward-looking statements', such as statements that include the words 'expect', 'estimate', 'project', 'anticipate', 'believes', 'should', 'intend', 'plan', 'could', 'probability', 'risk', 'Value-at-Risk (VaR)', 'target', 'goal', 'objective', 'will', 'endeavour', 'outlook', 'optimistic', 'prospects' and similar expressions or variations on such expressions.

In particular, this document includes forward-looking statements relating, but not limited to: RBSH Group's restructuring plans, divestments, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk weighted assets, return on equity, cost: income ratios, leverage and loan: deposit ratios, funding and risk profile, certain ring-fencing proposals, sustainability targets, RBSH 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 back-to-back contracts with The Royal Bank of Scotland plc (RBS plc), and RBSH 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 of the 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 financial condition of RBSG Group; the global economic and financial market conditions and other geopolitical risks and their impact on the financial industry in general and on RBSH Group in particular; the ability to access sufficient sources of liquidity and funding; 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 of RBSG Group; 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 plc; deteriorations in borrower and counterparty credit quality; the extent of future write-downs and impairment charges caused by depressed asset valuations; 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 RBSH 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 RBSH Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of RBSH Group's operations) in the Netherlands, the United States, the United Kingdom, the rest of Europe and other countries in which RBSH Group operates or a change in policy of the government of the Netherlands; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of the central banks and other governmental and regulatory bodies; changes in Dutch and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; pension fund shortfalls; general operational risks; reputational risk; general geopolitical and economic conditions in the Netherlands and in other countries in which RBSH Group has significant business activities or investments; the protection provided to RBSH Group pursuant to the asset backed protection scheme back-to-back contracts and their effect on RBSH Group's financial and capital position; the cross liability resulting from the legal demerger of ABN AMRO Bank N.V. and the Dutch Scheme; limitations on, or additional requirements imposed on, RBSH Group's activities as a result of HM Treasury's investment in RBSG Group; and the success of RBSH 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 RBSH 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.

For a further discussion of certain risks faced by RBSH Group, see Risk factors on pages 236 to 245.

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.

Description of business

Introduction

RBS Holdings N.V. is an international banking group offering a range of banking products and financial services on a global basis.

In 2007, RFS Holdings, which was jointly owned by RBSG, the Dutch State (successor to Fortis) and Santander (together, the 'Consortium Members') completed the acquisition of RBS Holdings.

RBS Holdings has one direct subsidiary, RBS N.V., a fully operational bank within RBSH Group. RBS N.V. is independently rated and regulated by the Dutch Central Bank. Certain assets within RBS N.V. continue to be owned by the Dutch State or shared by the Consortium Members.

As at 31 December 2010, RBSG's shareholding in RFS Holdings was increased to 97.7%. RFS Holdings is controlled by RBSG, which is incorporated in the UK and registered at 36 St. Andrew Square, Edinburgh, Scotland. RBSG is the ultimate parent company of RBSH Group. The consolidated financial statements of RBSH Group are included in the consolidated financial statements of RBSG Group.

RBSH Group had total assets of €146.7 billion and owners' equity of €3.3 billion at 31 December 2011. RBSH Group's capital ratios were a Total capital ratio of 17.5%, a Core Tier 1 capital ratio of 8.4% and a Tier 1 capital ratio of 12.0%, as at 31 December 2011.

Organisational structure and business overview

As at 31 December 2011, RBSH Group comprised four reportable segments, namely Global Banking & Markets (GBM), Global Transaction Services (GTS) and Central Items, together the 'Core' segments, and the Non-Core segment.

Global Banking & Markets (GBM) provides an extensive range of debt and equity financing, risk management and investment services as a leading banking partner to major corporations and financial institutions around the world. The GBM business is organised along four principal business lines: Global Lending, Equities, Short Term Markets & Funding and Local Markets.

Global Transaction Services (GTS) provides global transaction services, offering global trade finance, transaction banking and international cash management.

Central Items includes group and corporate functions, such as treasury, capital management and finance, risk management, legal, communications and human resources.

Non-Core contains a range of separately managed businesses and asset portfolios that RBSH Group intends to run-off or dispose, in line with RBSG Group strategy for Non-Core assets. It also includes the remaining assets and liabilities in RBS N.V. that have not yet been sold, wound down or alternatively transferred to the Consortium Members, referred to as 'Shared Assets', in which each of the consortium shareholders has a joint and indirect interest.

Organisational change

In January 2012, RBSG Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes will see the reorganisation of RBSG Group'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 RBSG Group's strategy.

The changes will 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.

Existing GBM and GTS divisions will be reorganised as follows:

- The 'Markets' business will maintain 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 RBSG Group businesses.

- GBM's corporate banking business will combine with the international businesses of the Global Transaction Services arm into a new 'International Banking' unit and provide clients with a 'one-stop shop' access to RBSG Group's debt financing, risk management and payments services. This international corporate business will be self-funded through its stable corporate deposit base.

RBSG Group's wholesale business will be retaining its international footprint to ensure that it can serve its 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.

In consequence, going forward RBSH Group will comprise the following segments:

- International Banking
- Markets
- Central Items
- Non-Core

Proposed transfers of a substantial part of the business activities of RBS N.V. to The Royal Bank of Scotland plc (RBS plc)

On 19 April 2011, the Boards of RBSG Group, RBS plc, RBS Holdings N.V. and RBS N.V. announced their intention to transfer a substantial part of the business activities of RBS N.V. to RBS plc (the Proposed Transfers), subject, amongst other matters, to regulatory and other approvals, further tax and other analysis in respect of the assets and liabilities to be transferred and employee consultation procedures.

The Proposed Transfers will streamline the manner in which the businesses within RBSH Group's Markets & International Banking (MIB) Divisions interact with clients and will provide simplified access to the MIB product suite. The Proposed Transfers will not result in any change to the current business strategy for any of the transferred RBS N.V. businesses and the way in which RBSH Group commercially operates will remain unchanged.

Description of business continued

The Proposed Transfers are consistent with RBSG Group’s efforts to simplify its structure, thereby reducing risk, cost and complexity. In addition, the Proposed Transfers are expected to result in a simplified management and reporting framework for the RBSG Group across the multiple jurisdictions in which RBS plc and RBS N.V. operate.

It is expected that the Proposed Transfers will be implemented on a phased basis over a period ending 31 December 2013. Certain unaudited pro forma condensed consolidated financial information relating to RBS Holdings N.V. is set out on pages 227-230.

The transfer of eligible business carried out in the UK, including certain securities issued by RBS N.V. was completed during the last quarter of 2011, the 'UK Transfer'. Much of this business is governed by UK law and as a result a large portion of the transfer was conducted through a banking business transfer scheme under Part VII of the UK Financial Services and Markets Act 2000 on 17 October 2011. This is a court and UK Financial Services Authority approved transfer scheme. Eligible business that could not be included in the scheme was transferred via novations or market mechanisms and UK subsidiaries of RBS N.V. were transferred by share sales.

The UK Transfer moved a large part of the UK Equities & Structured Retail, Markets, Lending and GTS businesses as well as part of the UK Non-Core portfolio. The UK Transfer resulted in the transfer of approximately €22 billion assets and €45 billion in liabilities as at the end of November 2011.

A large part of the remainder of Proposed Transfers (including the transfers of certain securities issued by RBS N.V.) is expected to have taken place by the end of 2012. Included within the Proposed Transfers for 2012 are assets and liabilities that meet the IFRS 5 definition of being Held for Sale as at 31 December 2011. These assets and liabilities, relating largely to businesses in Singapore, Kazakhstan and Australia, have been classified as assets and liabilities of disposal groups as at year end, see Note 19 page 159 for further details.

Competition

RBSH 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 de-lever and the economy has remained weak.

Competition for corporate and institutional customers in the Netherlands is from banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities. In asset finance, RBSH Group competes with banks and specialised asset finance providers. In other European and Asian corporate and institutional banking markets RBSH Group competes with the large domestic banks active in these markets and with the major international banks. In the small business banking market, RBSH Group competes with other European clearing banks, specialist finance providers and building societies.

Risk factors

Set out below are certain risk factors which could affect RBSH Group's future results and cause them to be materially different from expected results. RBSH Group's results are also affected by competition and other factors. These risk factors, discussed in more detail in Additional information (pages 236 to 245), should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

- RBSH Group is reliant on RBSG Group.
- RBSH Group's businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions and by other geopolitical risks.
- RBSH Group's ability to meet its obligations including funding commitments depends on RBSH Group's ability to access sources of liquidity and funding.
- The execution and/or any delay in the execution (or non-completion) of the approved proposed transfers of a substantial part of the business activities of RBS N.V. to RBS plc may have a material adverse effect on RBSH Group and may also negatively impact the value of securities issued by RBS Holdings N.V. and RBS N.V.
- An extensive restructuring and balance sheet reduction programme of the RBSG Group is ongoing and may adversely affect RBSH Group's business, results of operations, financial condition, capital ratios and liquidity and may also negatively impact the value of securities issued by RBS Holdings N.V. and RBS N.V.
- As a condition to the RBSG Group receiving HM Treasury support, RBSH Group is prohibited from making discretionary coupon payments on, and exercising call options in relation to, certain of its existing hybrid capital instruments, which may impair RBSH Group's ability to raise new capital through the issuance of Securities.
- The financial performance of RBSH Group has been, and continues to be, materially affected by deteriorations in borrower and counterparty credit quality and further deteriorations could arise due to prevailing economic and market conditions, and legal and regulatory developments.
- RBSH Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.
- Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect RBSH Group's business and results of operations.
- RBSH Group's borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its credit ratings.
- RBSH Group's business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements.
- RBSH Group is and may be subject to litigation and regulatory investigations that may impact its business.

- 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.

- RBSH Group operates in markets that are highly competitive and its business and results of operations may be adversely affected.

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

- Each of RBSH Group’s businesses is subject to substantial regulation and oversight. Significant regulatory developments, including changes in tax law, could have an adverse effect on how RBSH Group conducts its business and on its results of operations and financial condition.

- RBSH Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations.

- Operational risks are inherent in RBSH Group’s businesses.

- RBSH Group’s operations have inherent reputational risk.

- The recoverability and regulatory capital treatment of certain deferred tax assets recognised by RBSH Group depends on RBSH Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation, regulatory requirements or accounting standards.

- The extensive governance, asset management and information requirements under the Asset Protection Scheme conditions, which RBSH Group is required to comply with, or to ensure that RBS plc can comply with, pursuant to the APS back-to-back contracts may have an adverse impact on RBSH Group and expected benefits of the APS back-to-back contracts.

- Any changes to the expected regulatory capital treatment of the APS back-to-back contracts may have a material adverse impact on RBSH Group.

- The legal demerger of ABN AMRO Bank N.V. (as it was then named) has resulted in a cross liability that changes the legal recourse available to investors.

Key financials

for the year ended 31 December	2011 €m	2010 €m	2009 €m
Total income	3,929	3,872	1,397
Profit/(loss) before impairment losses	1,502	492	(3,224)
Operating (loss)/profit before tax	(263)	425	(4,847)

at 31 December	2011 €m	2010 €m	2009 €m
Total assets	146,672	200,382	469,345
Funded balance sheet (1)	127,534	172,110	411,953
Loans and advances to customers	29,578	44,496	219,958
Deposits	86,121	86,890	246,046
Equity attributable to controlling interests	3,318	4,948	18,880
Capital ratio's – Core Tier 1	8.4%	8.7%	16.9%
– Tier 1	12.0%	11.0%	19.9%
– Total	17.5%	15.8%	25.5%

Notes:
(1) Funded balance sheet represents total assets less derivatives.

Summary consolidated income statement

	2011 €m	2010 €m	2009 €m
Net interest income	688	1,427	1,834
Fees and commissions receivable	1,039	1,152	1,506
Fees and commissions payable	(367)	214	(483)
Other non-interest income/(loss)	2,569	1,079	(1,460)
Non-interest income/(loss)	3,241	2,445	(437)
Total income	3,929	3,872	1,397
Operating expenses	(2,427)	(3,380)	(4,621)
Profit/(loss) before impairment losses	1,502	492	(3,224)
Impairment losses	(1,765)	(67)	(1,623)
Operating (loss)/profit before tax	(263)	425	(4,847)
Tax (charge)/credit	(433)	(302)	465
(Loss)/profit from continuing operations	(696)	123	(4,382)
Profit/(loss) from discontinued operations, net of tax	40	985	(18)
(Loss)/profit for the year	(656)	1,108	(4,400)
Attributable to:			
Non-controlling interests	-	(2)	(1)
Controlling interests	(656)	1,110	(4,399)

2011 compared with 2010

Operating (loss)/profit before tax

Operating loss before tax for the year was €263 million compared with a profit of €425 million in 2010. The decrease largely results from higher impairment losses mainly due to the impairment of Greek sovereign bonds in 2011, which was partially offset by a fair value gain on own debt.

Total income

Total income increased by €57 million to €3,929 million compared with €3,872 million in 2010. This increase is mainly attributable to the fair value gain on own debt resulting in higher other non-interest income. The increase was offset by lower net interest and net fees and commissions' income mainly due to the transfer of businesses to RBS plc and the disposal of Non-Core operations.

Net interest income decreased by €739 million to €688 million compared with €1,427 million in 2010, reflecting further reductions in interest earning assets due to transfers to RBS plc and the disposal of Non-Core operations.

Non-interest income/(loss) increased by €796 million to €3,241 million compared with €2,445 million in 2010, primarily due to the increase in other operating income. This increase in other operating income is mainly attributable to the widening of credit spreads in the second half of 2011 which led to a fair value gain on own debt of €1,290 million compared with a gain of €250 million in 2010. This increase is partially offset by lower trading income in GBM due to the transfer of trading activities to RBS plc and lower trading income in Non-Core as a result of disposal of operations in Asia and the Americas.

Operating expenses

Operating expenses decreased by €953 million to €2,427 million compared with €3,380 million in 2010. This reflects the transfer of businesses to RBS plc and Non-Core disposals, thus reducing the scale of operations and number of employees within RBSH Group.

Impairment losses

Impairment losses were €1,765 million for the year ended 31 December 2011, compared with €67 million in 2010. The increase in impairment losses in 2011 relates to Greek sovereign available-for-sale bonds and related interest rate hedge adjustments, as a result of Greece's continuing fiscal difficulties. In addition, higher impairment charges on commercial loans were charged in 2011, compared with 2010.

In 2011, RBSH Group made total claims of €148 million under the APS back-to-back agreement with RBS plc. Total recoveries on previously claimed impairments amounted to €90 million, resulting in a net recovery from RBS plc of €58 million.

Tax

The effective tax rate for 2011 was (164.6)% compared with 71.0% in 2010 mainly as a result of losses on Greek sovereign available-for-sale bonds being not recoverable for tax purposes.

Profit/(loss) from discontinued operations

Discontinued operations recorded a €40 million profit after tax compared with a €985 million profit after tax for the prior year. The results from discontinued operations in the prior year are mainly attributable to the gain on the sale by RBSH Group of the Dutch State acquired businesses included in the new ABN AMRO Bank on 1 April 2010.

2010 compared with 2009

Operating profit/(loss) before tax

Operating profit before tax for the year was €425 million compared with a loss of €4,847 million in 2010. This increase results from an improvement in operating income following significant fair value losses in 2009, a reduction in operating expenses and lower loan impairments reflecting the gradual improvement in market conditions.

Total income

Total income increased 177% to €3,872 million compared with €1,397 million in 2009. This increase is principally due to the 2009 Non-Core losses on counterparty Credit Valuation Adjustments (CVA) and Collateralised Debt Obligations (CDO).

Net interest income decreased by €407 million, reflecting further reductions in interest earning assets, which were transferred to RBS plc. In addition interest income reduced by €162 million due to reductions in the balance sheet following Non-Core disposals in Asia and Latin America. The GBM business recorded a decrease in interest income of €367 million, as it continues to encounter significant margin pressures and higher liquidity costs than in 2009. The decrease in net interest income was partially offset by an adjustment made to the carrying value of the Tier 1 hybrid capital securities of €273 million. RBSG Group's legal ownership of RFS Holdings was increased to 98% on 31 December 2010 thereby giving RBSG Group majority legal ownership. The RFS restructure, legally bound RBSH Group to comply with the EC Burden Sharing restrictions already applied to RBSG Group. These restrictions result in an adjustment to the carrying value of these amortised cost securities.

Non-interest income/(loss) increased to €2,445 million from a loss of €437 million in 2009, primarily due to the increase in other operating income and income from trading activities. The increase in other operating income is mainly attributable to the non reoccurrence of the fair value losses on a portfolio of credit default swaps, used to hedge the loan book following the tightening of the credit spreads in the first half of 2009. These losses amounted to €2,024 million in 2009. The increase in trading income mainly relates to the non reoccurrence of high losses on counterparty CVAs of €1,279 million in the prior year against monoline insurers. Additionally, write-offs on CDOs in 2010 were €211 million lower. Exposures to monoline insurers and CDOs were substantially risk transferred to RBS plc in the first half of 2009. In addition, fee and commissions payable improved by €697 million largely due to a true-up in the fee calculation for the asset protection scheme (APS) back-to-back agreement between RBS N.V. and RBS plc of €625 million. The APS back-to-back fee charged to the income statement for 2010 was €249 million. For further details on the APS back-to-back agreement see page 92. The increase in non-interest income is partially offset by a decrease in fees and commissions receivable due to reduced business origination and activity following transfers of businesses to RBS plc.

Operating expenses

Operating expenses decreased from €4,621 million in 2009 to €3,380 million. This reflects the transfer of businesses to RBS plc and Non-Core disposals, thus reducing the scale of operations and number of employees within RBSH Group. Additionally the 2009 results included charges related to costs incurred on the sale of businesses in Asia and the related goodwill impairments.

Impairment losses

Impairment losses were €67 million for the year ended 31 December 2010, compared with €1,623 million in 2009. Large specific provisions were made in 2009 including a specific impairment for LyondellBasell lndustries. For further details on the LyondellBasell provision please see the discussion within Non-Core on page 24. For 2010 there are lower specific commercial and retail provisions, especially on consumer and card lending in Asia and Middle East.

In 2010, RBSH Group made total claims of €470 million under the APS back-to-back agreement with RBS plc. Total recoveries on previously claimed impairments amounted to €561 million, resulting in a net repayment to RBS plc of €91 million.

Tax

The effective tax rate for 2010 was 71.0% compared with 9.6% in 2009. This was mainly due to the revision of the tax rate in the UK.

Profit/(loss) from discontinued operations

Discontinued operations recorded a €985 million profit after tax compared with a €18 million loss after tax for the prior year. The results from discontinued operations are mainly attributable to the gain on the sale by RBSH Group of the Dutch State acquired businesses included in the new ABN AMRO Bank on 1 April 2010.

Analysis of results

Net interest income

	2011	2010	2009
	€m	€m	€m
Interest receivable	2,352	3,061	4,763
Interest payable	(1,664)	(1,634)	(2,929)
Net interest income	688	1,427	1,834
	%	%	%
Gross yield on interest-earning assets of the banking business (1)	2.1	2.4	1.4
Cost of interest-bearing liabilities of the banking business	(1.5)	(1.3)	(1.0)
Interest spread of the banking business (2)	0.6	1.1	0.4
Benefit from interest-free funds	0.0	(0.0)	0.2
Net interest margin of the banking business (3)	0.6	1.1	0.6

Yields, spreads and margins of the banking business	%	%	%
Gross yield (1)			
– Group	2.1	2.4	1.4
– Domestic	1.8	1.8	0.7
– Foreign	2.4	3.0	3.7
Interest spread (2)			
– Group	0.6	1.1	0.4
– Domestic	(0.1)	0.1	0.0
– Foreign	1.2	2.2	1.4
Net interest margin (3)			
– Group	0.6	1.1	0.6
– Domestic	(0.1)	(0.2)	0.3
– Foreign	1.2	2.3	1.2

Notes:

(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.

(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.

Analysis of results continued
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	– Domestic	4,945	139	2.8%	6,222	165	2.7%
	– Foreign	25,521	207	0.8%	20,961	192	0.9%
Loans and advances to customers	– Domestic	9,234	193	2.1%	9,726	362	3.7%
	– Foreign	28,463	1,058	3.7%	38,841	1,612	4.2%
Debt securities	– Domestic	34,764	560	1.6%	42,520	506	1.2%
	– Foreign	6,610	195	3.0%	6,780	224	3.3%
Interest-earning assets	– banking business	109,537	2,352	2.2%	125,050	3,061	2.4%
	– trading business	19,958			26,626		
Interest-earning assets		129,495			151,676		
Non-interest-earning assets		61,981			133,098		
Total assets		191,476			284,774		
Percentage of assets applicable to foreign operations		67.5%			56.7%		
Liabilities							
Deposits by banks	– Domestic	23,503	440	1.9%	31,277	524	1.7%
	– Foreign	30,657	125	0.4%	23,552	84	0.4%
Customer accounts: demand deposits	– Domestic	9,853	217	2.2%	8,051	89	1.1%
	– Foreign	21,378	270	1.3%	22,386	146	0.7%
Customer accounts: savings deposits	– Domestic	209	-	-	-	-	-
	– Foreign	197	5	2.5%	3,949	69	1.7%
Customer accounts: other time deposits	– Domestic	3,394	64	1.9%	1,910	46	2.4%
	– Foreign	5,796	175	3.0%	11,449	277	2.4%
Debt securities in issue	– Domestic	9,613	146	1.5%	22,406	361	1.6%
	– Foreign	3,049	53	1.7%	4,382	124	2.8%
Subordinated liabilities	– Domestic	3,335	79	2.4%	4,747	110	2.3%
	– Foreign	3,281	151	4.6%	2,855	(98)	(3.4%)
Internal funding of trading business	– Domestic				-	-	-
	– Foreign	(3,424)	(61)	1.8%	(6,941)	(98)	1.4%
Interest-bearing liabilities	– banking business	110,841	1,664	1.5%	130,023	1,634	1.5%
	– trading business	34,431			38,989		
Interest-bearing liabilities		145,272			169,012		

Non-interest-bearing liabilities:			
Demand deposits	– Domestic	-	990
	– Foreign	4,503	2,465
Other liabilities		37,220	106,034
Owners' equity		4,481	6,273
Total liabilities and owners' equity		191,476	284,774
Percentage of liabilities applicable to foreign operations		68.8%	56.1%

For notes to this table see page 16.

Analysis of results continued
Average balance sheet and related interest continued

		2009		
		Average balance €m	Interest €m	Rate %
Assets				
Loans and advances to banks	– Domestic	26,405	249	0.9%
	– Foreign	8,708	253	2.9%
Loans and advances to customers	– Domestic	165,556	795	0.5%
	– Foreign	63,247	2,484	3.9%
Debt securities	– Domestic	59,138	679	1.1%
	– Foreign	9,136	303	3.3%
Interest-earning assets	– banking business	332,190	4,763	1.4%
	– trading business	67,364		
Interest-earning assets		399,554		
Non-interest-earning assets		150,804		
Total assets		550,358		
Percentage of assets applicable to foreign operations		48.9%		
Liabilities				
Deposits by banks	– Domestic	35,489	134	0.4%
	– Foreign	14,216	594	4.2%
Customer accounts: demand deposits	– Domestic	50,402	195	0.4%
	– Foreign	22,326	149	0.7%
Customer accounts: savings deposits	– Domestic	57,215	6	0.0%
	– Foreign	9,734	118	1.2%
Customer accounts: other time deposits	– Domestic	25,416	411	1.6%
	– Foreign	25,587	336	1.3%
Debt securities in issue	– Domestic	62,529	684	1.1%
	– Foreign	10,472	246	2.3%
Subordinated liabilities	– Domestic	10,407	144	1.4%
	– Foreign	2,758	167	6.1%
Internal funding of trading business	– Domestic	-	-	-
	– Foreign	(27,248)	(255)	0.9%
Interest-bearing liabilities	– banking business	299,303	2,929	1.0%
	– trading business	82,223		
Interest-bearing liabilities		381,526		
Non-interest-bearing liabilities:				
Demand deposits	– Domestic	22,366		
	– Foreign	130,011		
Other liabilities				
Owners' equity		16,455		
Total liabilities and owners' equity		550,358		
Percentage of liabilities applicable to foreign operations		51.1%		

Notes:

(1) The analysis into Domestic and Foreign has been compiled on the basis of location of the entity in which the transaction takes place.

Analysis of results continued

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			
Domestic	(35)	9	(26)
Foreign	39	(24)	15
Loans and advances to customers			
Domestic	(17)	(152)	(169)
Foreign	(398)	(156)	(554)
Debt securities			
Domestic	(103)	157	54
Foreign	(6)	(23)	(29)
Total interest receivable of the banking business			
Domestic	(155)	14	(141)
Foreign	(365)	(203)	(568)
	(520)	(189)	(709)
Interest-bearing liabilities			
Deposits by banks			
Domestic	141	(57)	84
Foreign	(28)	(13)	(41)
Customer accounts: demand deposits			
Domestic	(24)	(104)	(128)
Foreign	7	(131)	(124)
Customer accounts: savings deposits			
Domestic	-	-	-
Foreign	86	(22)	64
Customer accounts: other time deposits			
Domestic	(30)	12	(18)
Foreign	159	(57)	102
Debt securities in issue			
Domestic	195	20	215
Foreign	31	40	71
Subordinated liabilities			
Domestic	33	(2)	31
Foreign	13	(262)	(249)
Internal funding of trading business			
Domestic	-	-	-

Foreign	(58)	21	(37)
Total interest payable of the banking business			
Domestic	315	(131)	184
Foreign	210	(424)	(214)
	525	(555)	(30)
Movement in net interest income			
Domestic	160	(117)	43
Foreign	(155)	(627)	(782)
	5	(744)	(739)

Analysis of results 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			
Domestic	(293)	209	(84)
Foreign	192	(253)	(61)
Loans and advances to customers			
Domestic	(1,366)	933	(433)
Foreign	(1,006)	134	(872)
Debt securities			
Domestic	(197)	24	(173)
Foreign	(78)	(1)	(79)
Total interest receivable of the banking business			
Domestic	(1,856)	1,166	(690)
Foreign	(892)	(120)	(1,012)
	(2,748)	1,046	(1,702)
Interest-bearing liabilities			
Deposits by banks			
Domestic	18	(407)	(389)
Foreign	(241)	751	510
Customer accounts: demand deposits			
Domestic	259	(152)	107
Foreign	-	3	3
Customer accounts: savings deposits			
Domestic	-	-	-
Foreign	88	(39)	49
Customer accounts: other time deposits			
Domestic	502	(136)	366
Foreign	248	(189)	59
Debt securities in issue			
Domestic	558	(235)	323
Foreign	165	(43)	122
Subordinated liabilities			
Domestic	102	(68)	34
Foreign	(6)	274	268
Internal funding of trading business			
Domestic	-	-	-
Foreign	(247)	90	(157)
Total interest payable of the banking business			
Domestic	1,439	(998)	441
Foreign	7	847	854

	1,446	(151)	1,295
Movement in net interest income			
Domestic	(417)	168	(249)
Foreign	(885)	727	(158)
	(1,302)	895	(407)

Notes:

(1) The analysis into the Domestic and Foreign has been compiled on the basis of location of the entity in which the transaction takes place.

Analysis of results continued
Credit market exposures

Credit and other market losses (1)	2011 €m	2010 €m	2009 €m
Monoline exposures	(6)	22	(1,279)
CDPCs (2)	-	(98)	95

Notes:
(1) Included in 'Income from trading activities' within non-interest income
(2) Credit derivative product companies.

2011 compared with 2010
Losses relating to monoline exposures were €6 million in 2011 compared with gains of €22 million in 2010.

Most of the monoline exposures were settled with the counterparties during 2011. The remaining exposures are hedged using an overlay swap transacted with RBS plc which transfers the daily movement in the CVA between RBSH Group and RBS plc for these trades. The mark-to-market of this swap with RBS plc was €4 million in favour of RBS plc at 31 December 2011 (€769 million at 31 December 2010).

Losses relating to CDPC exposures were nil in 2011, compared to a loss of €98 million in 2010. RBSH Group had fully novated its CDPCs exposure to RBS plc in the course of 2010.

The positions in mortgage and other asset backed securities (€17.4 billion at 31 December 2011) have seen a further decrease in 2011. The composition of the remaining AFS portfolio has not changed substantially from 31 December 2010. Included are €6.8 billion residential mortgage-backed securities covered by the Dutch mortgage guarantee scheme and €9.0 billion residential mortgage covered bonds the majority of which originated in Spain.

The net exposure to ABSs backed by assets other than residential mortgages, such as sovereign or public entities debt, amounts to €1.5 billion and is mainly related to European covered bonds held in the treasury portfolios.

2010 compared with 2009
Gains relating to monoline exposures were €22 million in 2010 compared with losses of €1,279 million in 2009.

The net gain through trading income in 2010 amounts to €22 million and relates mainly to release of the CVAs partially netted off by hedges and other movements. Hedges with bank counterparties include the overlay swap transacted with RBS plc which transfers the daily movement in the CVA between RBSH Group and RBS plc for these trades. The mark-to-market of this swap with RBS plc was €769 million in favour of RBS plc at 31 December 2010 (€405 million at 31 December 2009).

Losses relating to CDPC exposures were €98 million in 2010, compared to a gain of €95 million in 2009. RBSH Group fully novated its CDPCs exposure to RBS plc in the course of 2010.

The positions in mortgage and other asset backed securities (€18.4 billion at 31 December 2010) have seen a further decrease in 2010. The held for trading positions have been fully matured or sold off in 2010. The composition of the remaining AFS portfolio has not changed substantially from 31 December 2009. Included are €6.9 billion residential mortgage-backed securities covered by the Dutch mortgage guarantee scheme and €9.1 billion residential mortgage covered bonds, 98% of which originated in Europe, of which 81% in Spain.

83% of residential mortgage covered bonds were AAA rated at 31 December 2010. The net exposure to ABSs backed by assets other than residential mortgages, such as sovereign or public entities debt, amounts to €2.2 billion and is mainly related to AAA European (23% Germany, 21% Spain) covered bonds held in the treasury portfolios. The decrease is mainly due to the maturing of papers.

The CDO and CLO exposure decreased further in 2010 mainly due to the maturing of positions.

Additional disclosures on these and other related exposures can be found in the following sections.

Disclosure	Section	Sub section	Page
Further analysis of credit market exposures	Risk management	Monoline insurers	65
Valuation aspects	Financial statements	Note 9 Financial instruments - valuation	136
	Financial statements	Critical Accounting policies	122

Divisional performance

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

	2011	2010	2009
Operating (loss)/profit before tax	€m	€m	€m
Global Banking & Markets	1,591	856	39
Global Transaction Services	(168)	(64)	(4)
Central items	(1,270)	40	(385)
Core	153	832	(350)
Non-Core	(416)	(407)	(4,501)
Reconciling items (1)	-	-	4
	(263)	425	(4,847)

Notes:

(1) Segments are stated as they are reviewed by management and therefore exclude the effect of the consolidation of Private Equity businesses which is shown as a reconciling item in 2009.

Employee numbers at 31 December
(full time equivalents rounded to the nearest hundred)

	2011	2010	2009
Global Banking & Markets	6,300	6,700	8,300
Global Transaction Services	6,600	5,500	5,400
Central items	600	700	900
Core	13,500	12,900	14,600
Non-Core	4,200	6,400	13,000
	17,700	19,300	27,600

Global Banking & Markets (GBM)

	2011	2010	2009
	€m	€m	€m
Net interest income	240	451	818
Non-interest income	2,701	1,924	1,761
Total income	2,941	2,375	2,579
Direct expenses			
– staff costs	(747)	(967)	(1,368)
– other	(494)	(670)	(915)
Indirect expenses	(22)	24	1
	(1,263)	(1,613)	(2,282)
Profit before impairment losses	1,678	762	297
Impairment losses	(87)	94	(258)
Operating profit before tax	1,591	856	39
	€bn	€bn	€bn
Balance sheet			
Third party assets	84	130	180
Third party liabilities	77	122	166

2011 compared with 2010
Operating profit before tax was €1,591 million compared with €856 million for 2010.

Total income increased by €566 million to €2,941 million. The increase is mainly attributable to the increase in non-interest income due to a fair value gain on own debt which is only partially offset by lower net interest income.

Net interest income decreased by €211 million to €240 million compared with €451 million in 2010, reflecting further reductions in interest earning assets due to transfers to RBS plc.

Non-interest income increased by €777 million to €2,701 million in 2011 compared with €1,924 million in 2010. The increase in other operating income is mainly attributable to the widening of credit spreads in the second half of 2011 which led to a fair value gain on own debt of €879 million compared to a gain of €252 million in 2010. This increase is partially offset by lower income from trading activities due to the transfer of trading activities to RBS plc. In addition lower income from trading activities, reflects depressed primary market volumes, 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. The heightened volatility, increased risk aversion amongst clients and limited opportunities for revenue generation in the secondary markets.

Operating expenses have decreased by €350 million to €1,263 million compared with €1,613 million in 2010. This reflects the transfer of businesses to RBS plc, thus reducing the scale of operations in 2011.

Impairments losses were €87 million in 2011 compared with a credit of €94 million in 2010. The impairments in 2011 reflect a small number of single name provisions.

2010 compared with 2009

Operating profit before tax increased by €817 million to €856 million compared with €39 million for 2009.

Total income decreased by €204 million to €2,375 million. The reduction is mainly due to a significantly lower net interest income, partially offset by higher non-interest income. The results reflect continuing transfers of business to RBS plc as well as unfavourable market conditions.

Net interest income decreased by €367 million, as a result of higher liquidity costs in 2010 compared to 2009, when money markets benefited from rapidly falling short term interest rates, as well as ongoing transfer of the interest generating assets to RBS plc.

Non-interest income increased by €163 million to €1,924 million in 2010 compared to €1,761 million in 2009. The improvement reflects reduced losses attributable to movements in credit spreads, compared to the prior year when fair value losses were recognised on a portfolio of credit default swaps used to hedge the loan book following tightening of credit spreads. These losses amounted to €606 million in 2009 as compared to nil in 2010. Additional improvement in the non-interest income is due to a €111 million gain resulting from APS back-to-back fee agreement true-up. These improvements are offset by a decrease in trading income as a result of the absence of favourable market conditions which prevailed in 2009 especially in emerging market currency trading. In addition the reduced business origination and general market activity, have led to lower brokerage fees. Ongoing transfers of significant assets to RBS plc have resulted in lower earnings generating capabilities of the business.

Operating expenses have decreased by €669 million to €1,613 million from €2,282 million in 2009. This reflects the transfer of business to RBS plc, thus reducing the scale of operations in 2010.

Loan impairments in 2010 amounted to a credit of €94 million in comparison to a charge of €258 million in 2009. 2010 impairments reflect a small number of single name provisions, mainly on APS back-to-back covered assets, which are more than offset by several recoveries following the restructuring of impaired exposures.

Global Transaction Services (GTS)

	2011	2010	2009
	€m	€m	€m
Net interest income	316	306	355
Non-interest income	436	305	318
Total income	752	611	673
Direct expenses			
– staff	(272)	(283)	(236)
– other	(472)	(401)	(427)
Indirect expenses	2	5	13
	(742)	(679)	(650)
Profit/(loss) before impairment losses	10	(68)	23
Impairment losses	(178)	4	(27)
Operating loss before tax	(168)	(64)	(4)
	€bn	€bn	€bn
Balance sheet			
Third party assets	12	12	9
Third party liabilities	35	39	27

2011 compared with 2010
Operating loss before tax was €168 million compared with a loss of €64 million in 2010.

Total income increased by €141 million to €752 million with increases in both net interest income and non-interest income.

Net interest income increased by €10 million to €316 million compared with €306 million in 2010, largely due to strong deposit gathering activity.

The increase in non-interest income by €131 million to €436 million compared with €305 million in 2010 is mainly attributable to an increase of transactional exchange rate fees.

Operating expenses have increased by €63 million to €742 million compared with €679 million in 2010, reflecting investment in business improvement initiatives, technology and support infrastructure.

Impairment losses were €178 million compared with a credit of €4 million in 2010. The impairments in 2011 are largely driven by a single name provision.

2010 compared with 2009
Operating loss before tax was €64 million compared with a loss of €4 million in 2009.

Total income decreased by €62 million to €611 million with decreases in both net interest income and non-interest income.

Net interest income decreased by €49 million following transfers of businesses in Japan and Australia to RBS plc during 2009 and lower interest margins from transactions in Asia and Eastern Europe in 2010.

The decrease in non-interest income mainly relates to a decrease in net fee and commission income in the Netherlands as a result of client attrition in the second half of 2009 and lower margins on trade settlement products in Asia as the risk profile of the region improved.

Operating expenses have increased by €29 million from €650 million in 2009 reflecting increased investment in support infrastructure.

Central Items

	2011 €m	2010 €m	2009 €m
Net interest income/(loss)	(110)	43	(127)
Non-interest income	407	301	103
Total income/(loss)	297	344	(24)
Direct expenses			
– staff	(69)	(216)	(79)
– other	(49)	(71)	(280)
Indirect expenses	14	(17)	(2)
	(104)	(304)	(361)
Profit/(loss) before impairment losses	193	40	(385)
Impairment losses	(1,463)	-	-
Operating (loss)/profit before tax	(1,270)	40	(385)
	€bn	€bn	€bn
Balance sheet			
Third party assets	39	38	51
Third party liabilities	25	21	28

2011 compared with 2010
Operating loss before tax was €1,270 million compared with a profit of €40 million in 2010. The loss is largely due to the impairment losses relating to Greek sovereign available-for-sale bonds and related interest rate hedge adjustments.

Total income decreased by €47 million to €297 million compared with €344 million in 2010, mainly reflecting lower net interest income and lower income from trading activities due to discontinuation of the RBSH Group treasury trading book.

Net interest income declined by €153 million mainly due to 2010 interest income having benefited from an adjustment to the carrying value of the Tier 1 hybrid capital securities of €273 million under the EC Burden Sharing restrictions which did not reoccur in 2011.

Non-interest income increased by €106 million to €407 million compared with €301 million in 2010 mainly as a result of a fair value gain on own debt of €411 million compared to a loss of €2 million in 2010.

Operating expenses decreased by €200 million to €104 million compared with 2010 mainly as a result of lower staff expenses due to lower bonus and pension expenses.

Impairment losses were €1,463 million compared with no losses in 2010. The impairment losses in 2011 relate to Greek sovereign available-for-sale bonds and related interest rate hedge adjustments, as a result of Greece’s continuing fiscal difficulties.

2010 compared with 2009
Operating profit before tax was €40 million compared with a loss of €385 million in 2009.

Total income increased by €368 million to €344 million. This follows the improvement in both net interest and non-interest income.

Net interest income improved by €170 million. This increase is largely due to an adjustment made to the carrying value of the Tier 1 hybrid capital securities of €273 million. RBSG Group's legal ownership of RFS Holdings was increased to 98% on 31 December 2010 thereby giving RBSG Group majority legal ownership. The RFS restructure legally bound RBSH Group to the EC Burden Sharing restrictions already applied to RBSG Group. These restrictions result in an adjustment to the carrying value of the amortised cost securities.

Non-interest income increased by €198 million to €301 million from €103 million in 2009. The increase relates mainly to the gain on sale of US treasury bonds of €268 million. These instruments were divested as a consequence of a revised hedging strategy. The increase in non-interest income is partially offset by losses on the sales of Spanish, Greek and Portuguese bonds. In addition, following the Basel II implementation several Basel I securitisation programs were discontinued in the course of 2010 resulting in a €120 million reduction in fees and commissions payable.

Operating expenses decreased by €57 million to €304 million for the year ended 2010. The decrease is due mainly from the exceptional items in 2009 expenses including legal provisions and a goodwill impairment in Pakistan.

Non-Core

	2011 €m	2010 €m	2009 €m
Net interest income	242	627	788
Non-interest income	(303)	(85)	(2,646)
Total (loss)/income	(61)	542	(1,858)
Direct expenses			
– staff	(122)	(310)	(412)
– other	(197)	(462)	(882)
Indirect expenses	1	(12)	(11)
	(318)	(784)	(1,305)
Loss before other operating charges and impairment losses	(379)	(242)	(3,163)
Impairment losses	(37)	(165)	(1,338)
Operating loss before tax	(416)	(407)	(4,501)
	€bn	€bn	€bn
Balance sheet			
Third party assets	12	19	44
Third party liabilities	7	16	37

2011 compared with 2010
Operating loss before tax was €416 million compared with a loss of €407 million in the year 2010.

Total income decreased by €603 million to a loss of €61 million. This is mainly due to lower net interest income, net fees and commissions' income and income from trading activities which is partly offset by an increase in other operating income.

Net interest income decreased by €385 million to €242 million compared with €627 million in 2010. This decrease is largely due to the disposal of operations in Asia and the Americas.

Non-interest income decreased by €218 million to a loss of €303 million compared to a loss of €85 million in 2010. The decrease is mainly due to lower fees and commissions' income and income from trading activities as a result of the disposal of operations in Asia and the Americas. The decrease was partly offset by the increase in other operating income due to lower losses on sale and revaluation of assets compared to 2010, as well as the true up of the APS back-to-back premium of €85 million, see page 92 of this report for further details.

Operating expenses decreased by €466 million to €318 million compared with €784 million for the year 2010. Operating expenses decreased following the disposals during 2010.

Impairment losses in 2011 amounted to €37 million compared with €165 million in 2010.

2010 compared with 2009
Operating loss before tax was €407 million compared with a loss of €4,501 million in the year 2009.

Total income increased by €2,400 million to €542 million. This is due to an increase in non-interest income which is partly offset by a decrease in net interest income.

Net interest income decreased by €161 million. This decrease is largely due to the significant divestitures of the retail and commercial business activities in Asia (Taiwan, Hong Kong, Singapore, Pakistan and Indonesia), Americas (Chile, Colombia and Venezuela) and EMEA (United Arab Emirates and Kazakhstan) in the course of 2010.

The improvement in non-interest income relates to an increase in income from trading activities, which is due to the non-reoccurrence of high losses in the prior year on counterparty CVA adjustments against monoline insurers following transfers of the positions to RBS plc. These losses amounted to €1,279 million in 2009. In addition the result on credit default swaps used to hedge the loan portfolio were €1,418 higher in 2010 compared to the prior year.

Net fees and commissions income for 2010 includes an additional gain of €334 million resulting from a true-up in the fee calculation for the APS back-to-back agreement. The improvement in non-interest income was offset by an overall reduction in business activities as well as losses on sale of mentioned above operations.

Operating expenses decreased by €521 million from €1,305 million for the year 2009. This results mainly from the 2009 charges related to costs incurred on the sale of businesses in Asia and the related goodwill impairments. In addition, operating expenses decreased following Non-Core disposals during 2010.

Impairment losses in 2010 amounted to €165 million, as compared to €1,338 million in 2009. Impairment losses in 2009 included a specific impairment for LyondellBasell lndustries (LyondellBasell). LyondellBasell filed Chapter 11 bankruptcy in January 2009. At the time LyondellBasell entered Chapter 11, RBSH Group's exposure was €2.3 billion. During 2009, RBSH Group recorded an impairment provision charge of €548 million in respect of this exposure, the provision balance as at 31 December 2009 was €1,688 million, and the remaining Group's exposure was €591 million. RBSH Group's exposures to LyondellBasell were covered assets under the APS back-to-back financial guarantee contract with RBS plc, effectively transferring the risk of future losses and the right to recoveries.

2010 compared with 2009 continued

Accordingly, in 2010 €197 million recovered from LyondellBasell was passed on to RBS plc.

In April 2010, LyondellBasell announced that it had emerged from Chapter 11 bankruptcy protection following creditor and court approval for its Plan of Reorganisation (PoR). Following the PoR, RBSH Group's retained exposure was €689 million comprising a loan of €173 million (classified as loans and receivables), a 7.2% common equity stake of €501 million (designated as at fair value through profit or loss) and equity warrants of €15 million (classified as derivatives); a reversal of impairment losses of €336 million was recorded and passed on to RBS plc. The loan and common equity stake were sold in December 2010. The carrying value of the remaining LyondellBasell exposure, made up of warrants, was €32 million at 31 December 2010.

Consolidated balance sheet at 31 December 2011

	2011 €m	2010 €m	2009 €m
Assets			
Cash and balances at central banks	12,609	8,323	28,382
Net loans and advances to banks	17,953	22,433	31,343
Reverse repurchase agreements and stock borrowing	9,100	4,272	6,376
Loans and advances to banks	27,053	26,705	37,719
Net loans and advances to customers	29,295	40,608	210,712
Reverse repurchase agreements and stock borrowing	283	3,888	9,246
Loans and advances to customers	29,578	44,496	219,958
Debt securities	39,645	52,260	84,800
Equity shares	3,093	22,634	17,236
Settlement balances	2,608	3,573	3,398
Derivatives	19,138	28,272	57,392
Intangible assets	115	199	645
Property, plant and equipment	152	283	1,961
Deferred taxation	444	5,440	5,427
Prepayments, accrued income and other assets	5,018	5,388	7,538
Assets of disposal groups	7,219	2,809	4,889
Total assets	146,672	200,382	469,345
Liabilities			
Bank deposits	29,988	27,178	40,728
Repurchase agreements and stock lending	16,532	4,807	4,220
Deposits by banks	46,520	31,985	44,948
Customers deposits	38,842	49,886	198,388
Repurchase agreements and stock lending	759	5,019	2,710
Customer accounts	39,601	54,905	201,098
Debt securities in issue	17,714	53,411	96,291
Settlement balances and short positions	3,409	5,202	7,503
Derivatives	19,868	35,673	62,959
Accruals, deferred income and other liabilities	3,835	5,213	13,675
Retirement benefit liabilities	60	75	154
Deferred taxation	116	195	241
Subordinated liabilities	6,859	6,894	14,666
Liabilities of disposal groups	5,351	1,857	8,894
Total liabilities	143,333	195,410	450,429
Non-controlling interests	21	24	36
Controlling interests	3,318	4,948	18,880
Total equity	3,339	4,972	18,916
Total liabilities and equity	146,672	200,382	469,345

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Commentary on consolidated balance sheet
2011 compared with 2010
Total assets were €146.7 billion at 31 December 2011, a decrease of €53.7 billion, or 27%, when compared with €200.4 billion at 31 December 2010.

Cash and balances at central banks increased by €4.3 billion or 52% to €12.6 billion at 31 December 2011 compared with €8.3 billion at 31 December 2010 principally due to improvements in RBSH Group's structural liquidity position during 2011.

Loans and advances to banks increased by €0.4 billion, or 1%, to €27.1 billion at 31 December 2011 compared with €26.7 billion at 31 December 2010. Within this, reverse repurchase agreements and stock borrowing (reverse repos) were up €4.8 billion, 112%, to €9.1 billion primarily as a result of the investment of surplus liquidity in short-term assets. Bank placings declined by €4.4 billion, 20%, to €18.0 billion, as a result of lower current accounts and time deposits in Global Banking & Markets.

Loans and advances to customers declined €14.9 billion, 33%, to €29.6 billion. Within this, reverse repurchase agreements were down €3.6 billion, 92%, to €0.3 billion. Customer lending decreased by €11.3 billion, 28%, to €29.3 billion. This reflected the planned reductions in the last quarter of 2011 in relation to the UK transfers, see page 8 for further details, along with declines in the Netherlands GBM and GTS businesses. Provisions as a percentage of gross loans and advances to customers increased from 3.3% to 4.9%. This was largely driven by a single name provision in 2011, refer to pages 69 and 71 for further analysis of provisions.

Debt securities decreased by €12.6 billion to €39.6 billion, reflecting the planned reductions in the last quarter of 2011 in relation to the UK transfers, as well as a reduction in holdings of government and financial institution bonds within GBM and RBSH Group Treasury.

Equity shares decreased by €19.5 billion, to €3.1 billion. This reflected the planned reductions in the last quarter of 2011 in relation to the UK transfers and the closure of positions to reduce RBSH Groups' level of unsecured funding requirements to mitigate the potential impact of unfavourable market conditions.

Derivative assets decreased by €9.2 billion, or 33%, to €19.1 billion at 31 December 2011 compared with €28.3 billion at 31 December 2010. Derivative liabilities decreased by €15.8 billion, or 44%, to €19.9 billion at 31 December 2011 compared to the balance of €35.7 billion at 31 December 2010. This was largely attributable to the planned reductions in the last quarter of 2011 in relation to the UK transfers and the lower volume of over the counter traded derivatives.

The increase in assets and liabilities of disposal groups is due to the inclusion of assets and liabilities relating largely to businesses in Singapore, Australia and Kazakhstan. These businesses are part of the Proposed Transfers for 2012 that meet the IFRS 5 definition of being held for disposal as at 31 December 2011, see Note 19 page 159 for further details.

Total liabilities were €143.3 billion as at 31 December 2011, a decrease of €52.1 billion, or 27% decrease when compared with €195.4 billion at 31 December 2010.

Deposits by banks increased by €14.5 billion, 45%, to €46.5 billion, with higher repurchase agreements and stock lending (repos), up €11.7 billion, 244%, to €16.5 billion. This increase is largely due to increased funding from RBSG Group, see commentary on Debt securities in issue below for further details.

Customer accounts were down €15.3 billion, 28%, to €39.6 billion. Within this, repos decreased €4.2 billion, 84%, to €0.8 billion. Excluding repos, customer deposits were down €11.1 billion, 22%, at €38.8 billion. This reflected the planned reductions in the last quarter of 2011 in relation to the UK transfers (see page 8 for further details), along with the maturing of time deposits in the US and lower demand accounts in GBM businesses.

Debt securities in issue declined €35.7 billion, 67%, to €17.7 billion. This was largely attributable to the planned reductions in the last quarter of 2011 in relation to the UK transfers. A large part of the business carried on in the UK, issued debt in order to fund other parts of RBSH Group. This intra-group funding has, in the short term, been replaced by RBSG Group funding. The funding by RBSG Group will fall in line with the planned reduction of RBSH Group's balance sheet as part of the Proposed Transfers in 2012 and 2013. In addition the decrease in Debt securities in issue was as a result of reduced issuance by GBM and RBSH Group Treasury.

Owner's equity decreased by €1.6 billion, 34%, to €3.3 billion, driven by the attributable loss for the period of €0.7 billion and decreases in foreign exchange reserves of €0.4 billion reflecting gains recycled to profit and loss due to the UK Transfers, and a decrease in available-for-sale reserves of €0.4 billion. The decrease in available-for-sale reserves was due to the derecognition of the related deferred tax assets and fair value movements on available-for-sale securities which was partly offset by the recycling of the cumulative losses on RBSH Groups holding of Greek government bonds, that were recycled to profit and loss in the first half of 2011.

2010 compared with 2009
Total assets were €200.4 billion at 31 December 2010, a decrease of €269.0 billion, or 57%, when compared with €469.4 billion at 31 December 2009. The decrease in the balance sheet categories Loans and advances to customers, Intangible assets, Property, plant and equipment, Prepayments, accrued income and other assets was mostly due to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank on 1 April 2010.

Cash and balances at central banks decreased by €20.1 billion or 71% to €8.3 billion at 31 December 2010 compared with €28.4 billion at 31 December 2009 due to a reduction in surplus cash balances held at central banks and other liquid assets, which had been built up as a prudent measure ahead of the legal separation of the Dutch State acquired businesses. Following successful separation on 1 April 2010, the liquid assets and associated short-term wholesale funding were managed down to business as usual levels.

Loans and advances to banks decreased by €11.0 billion, or 29%, to €26.7 billion at 31 December 2010 compared with €37.7 billion at 31 December 2009. This decrease is predominantly attributable to a decrease in time deposits placed of €7.5 billion due to a dividend settlement with Santander, as well as the sale of Dutch State acquired businesses included in the new ABN AMRO Bank.

Debt securities decreased by €32.5 billion to €52.3 billion, reflecting the sale of Dutch State acquired businesses as well as a decrease in the fair value of government securities, and significant divestments of debt securities. Equity shares increased by €5.4 billion, to €22.6 billion, largely due to a recovery of the equity markets in 2010.

Derivative assets decreased by €29.1 billion, or 51%, to €28.3 billion at 31 December 2010 compared with €57.4 billion at 31 December 2009. Derivative liabilities decreased by €27.3 billion, or 43%, to €35.7 billion at 31 December 2010 compared to the balance of €63.0 billion at 31 December 2009. This was partly attributable to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank, the novation to RBS plc of derivative financial instruments and the lower volume of over the counter traded derivatives.

Total liabilities were €195.4 billion as at 31 December 2010, a decrease of €255.0 billion, or 57% decrease when compared with €450.4 billion at 31 December 2009. The balance sheet categories Deposits by banks, Customer accounts, Debt securities in issue, Subordinated liabilities, and Accruals, deferred income and other liabilities have significantly decreased due to the sale of Dutch State acquired businesses included in the new ABN AMRO Bank N.V. on 1 April 2010.

Total equity at 31 December 2010 was €5.0 billion, a decrease of €14.0 billion compared to 31 December 2009. This was mainly due to a decrease in share premium and retained earnings as a result of the €9.0 billion dividend distributions by RBS Holdings to RFS Holdings for the benefit of Santander, coupled with a €6.5 billion dividend distribution for the benefit of the Dutch State as part of the sale of the new ABN AMRO Bank on 1 April 2010. In addition, during the period, €1.4 billion in unrealized losses were recorded in other comprehensive income predominantly relating to available-for-sale debt securities. Cash flow hedging reserves improved by €1.0 billion due to the realization of reserves following the sale of the new ABN AMRO Bank. In order to capitalize the remaining shared assets and the remaining Dutch State acquired businesses, Santander and the Dutch state injected €0.1 billion and €0.3 billion, respectively in capital. RBSG Group injected €0.5 billion in the second half of 2010 in order to further strengthen RBSH Group's capital position.

Risk and balance sheet management

Risk and balance sheet management are conducted on an overall basis within RBSG Group. Therefore the discussion on risk and balance sheet management on pages 29 to 93 refers principally to policies and procedures in RBSG Group that also apply to RBSH Group.

Introduction

Risk Management plays an integral role in the delivery of RBSG Group's strategic goal to be a safe and secure banking group. Given this central aim, in 2009 RBSG Group's Board set out four key strategic risk objectives, aligned to RBSG Group's strategic plan. These are to:

- maintain capital adequacy
- deliver stable earnings growth
- ensure stable and efficient access to funding and liquidity
- maintain stakeholder confidence

These strategic risk objectives are the bridge between the RBSG 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.

More detailed discussions on how RBSH Group strengthened its approach to risk management in 2011 are contained within the following pages.

Risk appetite

RBSH Group's risk appetite identifies and establishes the level and type of risks that it is able and willing to take in executing its chosen business strategy, to protect itself against events that may have an adverse impact on its profitability and/or its capital base. RBSH Group has developed a framework that sets and implements an appropriate risk appetite supported by a regular monitoring and review process.

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 RBSH Group's decision-making process in the context of the wider economic environment.

Internal stress tests

RBSH 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.

Stress testing forms part of RBSH 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 was utilised as a key decision making and capital planning tool as part of the planning for the Proposed Transfers (the transfer of a substantial part of the business activities of RBS N.V. to RBS plc).

RBSG Group Policy Framework

The RBSG Group Policy Framework (GPF) has been revised and broadened in 2011. 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 RBSG 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:

- RBSG 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 RBSG 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.

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

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

- all of RBSG Group's policy standards were benchmarked against relevant external reference points. Further improvements to the policy standards are now being implemented;

- for each policy standard, appropriate risk-based assurance activity was introduced to ensure 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

Risk and balance sheet management strategies are owned and set by the Managing Board of RBSH Group and are implemented by the executive management. There are a number of committees and executives that support the execution of the business plan and strategy. Two of these committees are dedicated to RBSH Group and report to the RBSH Group Managing Board and the RBSH Group Supervisory Board. These are depicted and described in the graph and table below. Matters not specifically delegated are reserved for the Managing Board.

There are also risk committees that cover RBSH Group and (parts of) RBSG Group reflecting the integrated manner in which the business is managed within RBSG Group. RBSH Group is represented in these committees by members who have delegated authority from RBSH Group to facilitate an integrated and efficient decision process, these specialist risk sub-committees are shown below. The authorities delegated to these variously convened committees are recorded in RBSH Group's High Level Control Report, which is reviewed, updated and approved by the Managing Board on a regular basis.

Notes:

(1) The RBSG Group Risk Committee and the GALCO report directly to the RBSG Executive Risk Forum.

(2) The RBSG Capital and Stress Testing Committee is a sub-committee of the GALCO.

During 2011, the role and responsibilities of key risk committees were reviewed and more clearly defined, to meet the future needs of RBSG Group.

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

Board/Committee	Risk focus	Membership
Supervisory Board	The Supervisory Board is responsible for supervising RBSH Group's management and RBSH Group's general affairs and the business connected with it and for advising the Managing Board.	Consists of five members. Three members are executives of RBSG Group.
Managing Board	Reports to RBSH Group Supervisory Board and is the principal decision making forum for RBSH Group. It approves the RBSH Group strategy and monitors the performance of the entity. It also reviews acquisitions, disposals and other significant transactions, and is responsible for capital entry management and allocation and determines dividend policy. It ensures that RBSH Group manages risk effectively through approving and monitoring of the risk appetite, considering Group stress scenarios and agreed mitigants and identifying longer-term strategic threats to RBSH Group's business operations.	Five members led by the RBSH Group Chairman, also Head of GBM, RBSH Group Chief Administrative Officer (CAO), RBSH Group Chief Financial Officer (CFO), RBSH Group Chief Risk Officer (CRO) and RBSH Group Head of GTS.
Risk & Audit Committee (R&A Cte)	A sub-committee of the Supervisory Board. The RBSH Group Risk & Audit Committee is responsible for the review of all matters relative to accounting policies, internal control, financial reporting functions, internal audit, external audit, risk assessment and regulatory compliance and it assists on such other matters as may be referred to it by the RBSH Group Supervisory Board and or the RBSG Group Audit Committee.	The members of the RBSH Group R&A Cte are appointed by the Supervisory Board from its own members.
Asset & Liability Committee (ALCO)	A sub-committee of the Managing Board. The objective of the RBSH Group ALCO is to describe the framework within which RBSH Group manages its Balance Sheet and the structural exposures inherent therein. This framework is approved by the RBSH Group Managing Board and is fully aligned with the policies and procedures governing asset and liability management throughout RBSG Group.	Eleven permanent voting members led by the RBSH Group Chairman and Head of GBM, RBSH Group CFO, RBSH Group CAO, RBSH Group CRO, RBSH Group Treasurer, RBSH Group Head of GTS, GBM Treasurer, Head of Treasury Balance Sheet Management, Head of Treasury Capital Management, Head of Short Term Markets & Financing. Four permanent non-voting guests: GTS Treasurer, Non-Core Treasurer, Global Head of Equity Treasury, Europe Treasurer.
Risk and Control	A sub-committee of the Managing Board. The role of the RBSH Group Risk & Control Committee is to advise the RBSH Group Managing	Chaired by the RBSH Group CRO. Members include RBSH Group CFO, RBSH Group CAO, Head of GBM, RBSG Chief Operating

Committee (RCC)	Board on the risk appetite and receive direction from the RBSH Group Managing Board on the risk appetite. It oversees the risk framework and reports directly to the RBSH Group Managing Board on the performance of the framework and on issues arising from it. It monitors the actual risk profile and ensures that this remains within the boundaries of the agreed risk appetite or escalates excesses to the RBSH Group Managing Board.	Officer of GTS, Heads of Credit, Market, and Operational Risk & Regulatory Risk for RBSH Group, CRO EMEA, CROs for Risk for GBM Asia Pacific and Americas.

Risk coverage

The main risk types faced by RBSH Group are presented below, together with a summary of the key areas of focus and how RBSH Group managed these risks in 2010:

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2011
Capital, funding and liquidity risk	The risk that RBSH 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 RBSH Group. Potential to cause RBSH Group to fail to meet the supervisory requirements of regulators. Significantly driven by credit risk losses.	RBSH Group plans for and maintains an adequate amount and mix of capital consistent with its risk profile. This ensures that in any foreseeable scenario RBSH 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. Maintaining the structural integrity of RBSH Group's balance sheet requires active management of both asset and liability portfolios as necessary. Strong debt issuance and planned reductions in the funding balance sheet enabled RBSH Group to strengthen its funding and liquidity position as market conditions worsened.
Credit risk (including counterparty risk)	The risk that RBSH 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.	RBSH 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.
Country risk	The risk of material losses arising from significant country-specific	Can arise from sovereign events, economic events, political events,	All country exposures are covered by RBSG Group's country risk management framework. This includes active management of portfolios either when these have been identified as exhibiting signs

events.	natural disasters or conflicts. Potential to affect parts of RBSH Group's credit portfolio that are directly or indirectly linked to the country in question.	of stress through RBSG Group's country Watchlist process or when it is otherwise considered appropriate. Portfolio reviews are undertaken to align country risk profiles to RBSG 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 loss recognised by RBSH Group in 2011 in respect of available-for-sale Greek government bonds. In response RBSG 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.

Risk and balance sheet management
Risk coverage continued

Risk type	Definition	Features	How RBSH Group manages risk and the progress 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 RBSH Group does not exceed its qualitative and quantitative tolerance for market risk. RBSG 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 RBSH Group's trading and non-trading investment activities. The RBSG Group Market Risk limit framework expresses the RBSG Group's quantitative tolerance for market risk. The RBSG Group limit metrics capture, in broad terms, the full range of market risk exposures, ensuring the risk is appropriately defined and communicated.
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, RBSG Group took steps to enhance its management of operational risks. This is particularly evident in respect of setting risk appetite, the RBSG Group Policy Framework, risk assessment, scenario analysis and statistical modeling for capital requirements. The level of operational risk remains high due to the scale of structural change occurring across RBSH Group, the pace of regulatory change, the economic downturn and other external threats, such as e-crime.
Compliance risk	The risk arising from non-compliance with	Adverse impacts on strategy, capital	Management of compliance risk entails early identification and effective management of changes

national and international laws, rules and regulations.	structure, business models and operational effectiveness. Financial cost of adapting to changes in laws, rules or regulations or of penalties for non-compliance.	in legislative, regulatory and other requirements that may affect RBSH 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, RBSH 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 operating models, tools, systems and processes.

Risk and balance sheet management
Risk coverage continued

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2011
Reputational risk	The risk of brand damage arising from financial and non-financial losses due to failure to meet stakeholders' expectations of RBSG 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 RBSG Group or a failure to take action.	The RBSG Group Sustainability Committee (GSC) and risk committees continue to assess reputational risk issues. In 2011, an RBSG Group Environmental, Social and Ethical (ESE) Risk Policy was developed with sector ESE risk appetite positions drawn up to assess RBSG Group's appetite to support customers in sensitive sectors including defence and 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 GSC and relevant advocacy groups and non-governmental organisations.
Business risk	The risk of lower-than-expected revenues and/or higher-than-expected operating costs.	Influenced by many factors such as pricing, sales volume, input costs, regulations and market and economic conditions.	Forecasts of revenues and costs are tested against a range of stress scenarios to identify key risk drivers and the appropriate actions to address and manage them.
Pension risk	The risk that RBSH Group may 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.	RBSH Group manages pension risk from a sponsor perspective using a framework that encompasses risk reporting and monitoring, stress testing, modeling and an associated governance structure that helps ensure RBSH Group is able to fulfill its obligation to support the defined benefit pension schemes to which it has exposure. In 2011, RBSH Group focused on improved stress testing and risk governance mechanisms. The schemes are invested in diversified portfolios of equities, government and corporate fixed-interest and index-linked bonds, and other assets including property. Interest and inflation risks are mitigated partially by investment in suitable physical assets and appropriate derivative contracts.

Each of these risk types maps into RBSH 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.

Balance sheet management

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

Capital management

RBSH 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. RBSH Group operates within the 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 RBSH Group maintains sufficient capital to uphold investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

Governance

RBSH Group Asset and Liability Management Committee (ALCO) is responsible for ensuring RBSH Group maintains adequate capital at all times. The newly established RBSG Group 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 ALCO and comprises senior representatives from RBSH Group Risk, RBSH Group Finance and RBSH Group Treasury.

Determining appropriate capital

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

RBSH Group's own determination of how much capital is sufficient is derived from the desired credit rating level, risk appetite 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, RBSH Group aims to maintain capital adequacy.

RBSH 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 position of RBSH Group. In the event that the projected position deteriorates beyond acceptable levels, RBSH Group would revise business plans accordingly.

Stress testing approaches are used to continually determine the level of capital required to ensure RBSH Group remains adequately capitalised (see page 29).

Capital allocation

Capital resources are allocated to RBSH Group's businesses based on key performance parameters agreed by the Managing 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 the target returns set by the Managing 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.

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

RBSH Group has regard to the supervisory requirements of De Nederlandsche Bank (DNB). The DNB uses the capital ratio as a measure of capital adequacy in the Netherlands banking sector, comparing a bank's capital resources with its risk-weighted assets (RWAs) (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks); by international agreement, the Total Capital Ratio should be not less than 8% with a Tier 1 Capital Ratio of not less than 4%.

Balance sheet management continued
Capital management continued
Capital adequacy
RBSH Group's RWAs and capital ratios are set out below.

	2011	2010	2009 (2)
Risk-weighted assets	€m	€m	€m
Credit risk	50,195	64,200	115,953
Market risk (1)	5,353	1,272	1,582
Operational risk	3,163	4,324	-
	58,711	69,796	117,535
Capital ratios	%	%	%
Core Tier 1	8.4	8.7	16.9
Tier 1	12.0	11.0	19.9
Total	17.5	15.8	25.5

Notes:

(1) Market risk RWAs were largely impacted by the new CRD III rules.

(2) The data for 2009 is on a Basel I basis.

With effect from 30 June 2010, RBSH Group migrated to Basel II status. For the majority of credit risk, RBSH Group uses the advanced internal ratings based approach for calculating RWAs. For operational risk, RBSH Group uses the standardised approach, which calculates operational RWAs based on gross income.

The risk-weighted assets for 2011 reduced due to changes in the structure of the balance sheet following reductions in Non-Core and the UK Transfers. The risk-weighted assets and capital ratios published for 2009 were calculated on a Basel I basis and reflect the inclusion of the Dutch State and Santander acquired businesses existing in the period prior to the legal separation of ABN AMRO Bank on 1 April 2010.

RBSH Group is consolidated for regulatory reporting within RBSG Group. Pillar 3 information for RBSH Group is included within RBSG Group Pillar 3 disclosures. RBSG 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 RBSG 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 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.

Balance sheet management continued
Capital management continued
RBSH Group's regulatory capital resources were as follow:

Composition of regulatory capital	2011 €m	2010 €m	2009 €m
Tier 1			
Controlling interests	3,318	4,948	18,880
Non-controlling interests	21	24	36
Adjustment for:			
– Goodwill and other intangible assets	(10)	(25)	(103)
– Unrealised losses on available-for-sale debt securities	3,066	2,530	1,059
– Unrealised gains on available-for-sale equities	(148)	(112)	(219)
– Other regulatory adjustments	(1,298)	(1,265)	192
Core Tier 1	4,949	6,100	19,845
Preference shares	2,511	2,421	5,014
Less deductions from Tier 1 capital	(427)	(838)	(1,485)
Total Tier 1	7,033	7,683	23,374
Tier 2			
Unrealised gains on available-for-sale equities	148	112	219
Perpetual subordinated debt	3,699	4,105	7,841
Less deductions from Tier 2 capital	(591)	(838)	(1,485)
Total Tier 2	3,256	3,379	6,575
Tier 3	-	-	-
Total regulatory capital	10,289	11,062	29,949

Movement in Core Tier 1 capital	2011 €m
As at 1 January 2011	6,100
Regulatory adjustment: fair value changes in own credit spreads	(47)
Foreign currency reserves	(477)
Loss of non-controlling interest and reduction in goodwill	12
Result current year	(656)
Other	17
As at 31 December 2011	4,949

Balance sheet management continued
Capital management continued
Regulatory developments
Basel III
The rules used 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 are 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 common equity Tier 1 capital commencing 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.

Other regulatory capital change
RBSH 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 Proposed Transfers, the continued run-down and disposal of Non-Core assets and deleveraging in GBM where the business will focus 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.

Balance sheet management: Liquidity and funding risk

Liquidity risk

Liquidity risk is the risk that RBSH 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 RBSH 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 RBSH Group's risk reduction strategy.

Funding issuance

RBSH 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 GBM's international client base. RBSH Group's wholesale funding is well diversified by currency, geography, maturity and type.

Balance sheet composition

RBSH Group's balance sheet composition is a function of the product offerings and 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.

RBSH Group accesses professional markets funding by way of debt issuances on an unsecured and secured basis in numerous geographies, currencies and maturities.

Stress testing

The strength of a bank's liquidity risk management can only be evaluated based on its ability to survive under stress. RBSH 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. 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.

RBSH 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

RBSH Group has a Contingency Funding Plan (CFP) which is maintained and 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 RBSH Group's liquidity needs in the stress environments. The RBSH Group’s CFP is fully integrated with the CFP of RBSG Group.

Liquidity reserves

RBSH 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

RBSH Group operates in multiple jurisdictions and is subject to a number of regulatory regimes. RBSH Group's lead regulator in the Netherlands is De Nederlandsche Bank (DNB). RBSH Group is a subsidiary of the RBSG Group whose lead regulator in the UK is the Financial Services Authority (FSA).

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 (BCBS) 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.

Balance sheet management: Liquidity and funding risk continued

Funding sources

The table below shows RBSH Group's primary funding sources, excluding repurchase agreements.

	2011		2010		2009	
	€m	%	€m	%	€m	%
Deposits by banks	29,988	32.1	27,178	19.8	40,728	11.6
Debt securities in issue						
- Commercial paper	1,563	1.7	5,843	4.3	19,368	5.5
- Certificates of deposit	2,326	2.5	2,882	2.1	1,811	0.5
- Medium term notes and other bonds	13,521	14.5	44,369	32.3	74,330	21.3
- Securitisations	304	0.3	317	0.2	782	0.2
	17,714	19.0	53,411	38.9	96,291	27.5
Subordinated liabilities	6,859	7.3	6,894	5.0	14,666	4.2
Total wholesale funding	54,561	58.4	87,483	63.7	151,685	43.3
Customer deposits	38,842	41.6	49,886	36.3	198,388	56.7
Total funding	93,403	100.0	137,369	100.0	350,073	100.0

The tables below show RBSH Group's debt securities in issue and subordinated liabilities by remaining maturity.

	Debt securities in issue						
	Commercial paper and certificates of deposit	MTNs	Securitisations	Total	Subordinated liabilities	Total	
2011	€m	€m	€m	€m	€m	€m	%
Less than one year	3,887	1,711	-	5,598	61	5,659	23.0
1-3 years	-	4,353	-	4,353	56	4,409	18.0
3-5 years	2	4,233	-	4,235	2,672	6,907	28.1
More than 5 years	-	3,168	360	3,528	4,070	7,598	30.9
	3,889	13,465	360	17,714	6,859	24,573	100.0
2010							
Less than one year	8,721	5,741	-	14,462	4	14,466	24.0
1-3 years	2	10,560	-	10,562	-	10,562	17.5
3-5 years	2	11,141	-	11,143	2,592	13,735	22.8
More than 5 years	-	16,876	368	17,244	4,298	21,542	35.7
	8,725	44,318	368	53,411	6,894	60,305	100.0
2009							
Less than one year	20,139	19,620	-	39,759	857	40,616	36.6
1-5 years	776	25,985	-	26,761	9	26,770	24.1

More than 5 years	264	28,725	782	29,771	13,800	43,571	39.3
	21,179	74,330	782	96,291	14,666	110,957	100.0

Key point

- The reduction of medium term notes is related to the UK Transfers of Equities and Structured Retail business that was completed in the last quarter of 2011.

Balance sheet management: Liquidity and funding risk continued

Short-term borrowings

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

Short-term borrowings comprise repurchase agreements, commercial paper and certificates of deposit.

	Repurchase agreements	Commercial paper	Certificates of deposit	Total 2011	Total 2010	Total 2009
At year end						
- balance (€bn)	17	2	2	21	21	27
- weighted average interest rate	0.7%	0.9%	1.5%	0.8%	0.6%	1.7%
During the year						
- maximum balance (€bn)	35	3	8	46	44	66
- average balance (€bn)	11	2	5	18	28	40
- weighted average interest rate	0.7%	0.8%	1.2%	0.9%	0.6%	1.8%

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.

Liquidity management

Liquidity risk management requires ongoing assessment and calibration of: how the various sources of RBSH Group's liquidity risk interact with each other; market dynamics; and regulatory developments to determine the overall size of RBSH 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 RBSH 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.

Liquidity portfolio

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

	2011 Average €m	2011 Period end €m	2010 €m
Cash and cash equivalents	10,132	14,346	8,323
Central and local government bonds			
- AAA rated governments and US agencies	4,367	-	4,949
- AA- to AA+ rated governments	1,594	-	1,554
- governments rated below AA	1,059	1,142	1,193
- local government	5,469	5,143	6,576
	12,489	6,285	14,272

Unencumbered collateral			
- AAA rated	4,704	3,907	7,759
- below AAA rated and other high quality assets	2,780	3,536	3,680
	7,484	7,443	11,439
Total liquidity portfolio	30,105	28,074	34,034

Key points

- RBSH Group's central liquidity reserves reduced by €6 billion to €28 billion as at year end.

- RBSH Group manages the composition of its liquidity reserves based on a number of considerations. These include market opportunities, internal and external liquidity metrics and potential near term cash requirements. In response to the challenging economic conditions, RBSH Group has altered the composition of the portfolio resulting in a higher proportion of cash and cash equivalents, 51% at December 2011 compared with 24% at December 2010.

- The composition of the liquidity portfolio will vary over time based on changing regulatory requirements and internal evaluation of liquidity needs under stress.

- There are no restrictions over the disposition of the portfolio by RBSG Group management subject to meeting liquidity requirements imposed by the DNB.

Balance sheet management: Liquidity and funding risk continued

Assets and liabilities by contractual cash flow maturity

The tables below shows 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.

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	12,607	2	-	-	-	-
Loans and advances to banks	24,095	-	533	1,306	309	580
Debt securities	5,108	3,794	7,808	5,745	11,619	2,731
Settlement balances	2,595	10	-	-	-	-
Other financial assets	-	-	-	-	-	-
Total maturing assets (a)	44,405	3,806	8,341	7,051	11,928	3,311
Loans and advances to customers	11,539	5,657	5,822	3,902	2,986	1,349
Derivatives held for hedging (1)	37	54	206	116	19	12
	55,981	9,517	14,369	11,069	14,933	4,672
Liabilities by contractual maturity						
Deposits by banks	43,741	1,067	694	860	204	25
Debt securities in issue	3,737	2,104	4,855	4,444	2,734	1,344
Subordinated liabilities	54	177	256	2,981	1,514	1,006
Settlement balances and other liabilities	3,209	16	14	70	99	1
Total maturing liabilities (b)	50,741	3,364	5,819	8,355	4,551	2,376
Customer accounts	36,929	843	595	524	691	30
Derivatives held for hedging (1)	197	309	948	517	390	202
	87,867	4,516	7,362	9,396	5,632	2,608
Maturity gap (a – b)	(6,336)	442	2,522	(1,304)	7,377	935
Cumulative maturity gap	(6,336)	(5,894)	(3,372)	(4,676)	2,701	3,636

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

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	8,294	-	-	-	-	29
Loans and advances to banks	24,290	1,056	716	164	470	10
Debt securities	7,257	4,674	12,255	12,352	10,485	6,811
Settlement balances	3,573	-	-	-	-	-
Other financial assets	-	-	235	402	-	-
Total maturing assets	43,414	5,730	13,206	12,918	10,955	6,850
Loans and advances to customers	19,329	5,925	10,687	6,063	4,161	1,634
Derivatives held for hedging (1)	45	65	303	139	129	69
	62,788	11,720	24,196	19,120	15,245	8,553
Liabilities by contractual maturity						
Deposits by banks	27,450	1,659	899	706	812	245
Debt securities in issue	8,239	6,590	12,757	11,412	12,628	3,048
Subordinated liabilities	88	324	504	3,507	1,465	1,162
Settlement balances and other liabilities	4,287	65	139	266	436	-
Total maturing liabilities	40,064	8,638	14,299	15,891	15,341	4,455
Customer accounts	46,612	1,484	1,199	1,263	2,672	1,948
Derivatives held for hedging (1)	323	449	1,373	627	459	260
	86,999	10,571	16,871	17,781	18,472	6,663
Maturity gap	3,350	(2,908)	(1,093)	(2,973)	(4,386)	2,395
Cumulative maturity gap	3,350	442	(651)	(3,624)	(8,010)	(5,615)

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	28,400	-	-	-	-	24
Loans and advances to banks	34,253	614	901	927	1,063	187
Debt securities	14,299	9,182	12,257	13,069	27,234	7,195
Settlement balances	3,397	-	-	-	-	-
Other financial assets	-	166	194	204	-	-
Total maturing assets	80,349	9,962	13,352	14,200	28,297	7,406
Loans and advances to customers	58,564	9,662	19,335	20,938	28,021	35,599
Derivatives held for hedging (1)	345	345	1,487	1,487	511	-
	139,258	19,969	34,174	36,625	56,829	43,005
Liabilities by contractual maturity						
Deposits by banks	31,531	9,789	1,535	1,615	1,003	90
Debt securities in issue	20,634	20,085	14,132	15,019	30,312	1,967
Subordinated liabilities	122	847	23	24	9,310	192
Settlement balances and other liabilities	7,569	-	-	-	-	-
Total maturing liabilities	59,856	30,721	15,690	16,658	40,625	2,249
Customer accounts	183,244	6,548	2,109	2,206	4,125	3,030
Derivatives held for hedging (1)	482	482	1,777	1,778	3,684	-
	243,582	37,751	19,576	20,642	48,434	5,279
Maturity gap	20,493	(20,759)	(2,338)	(2,458)	(12,328)	5,157
Cumulative maturity gap	20,493	(266)	(2,604)	(5,062)	(17,390)	(12,233)

Guarantees and commitments	2011 €m	2010 €m	2009 €m
Guarantees (2)	19,901	24,458	33,568
Commitments (3)	22,378	37,995	51,520
	42,279	62,453	85,088

Notes:
(1) Held -for-trading derivative assets and liabilities amounting to €18.7 billion (assets) and €17.6 billion (liabilities) (2010 - €27.6 billion assets and €32.8 billion liabilities; 2009 - €56.3 billion assets and €59.1 billion liabilities) have been excluded from the table in view of their short-term nature.
(2) RBSH Group is only called upon to satisfy a guarantee when the guaranteed party fails to meet its obligations. RBSH Group expects most guarantees it provides to expire unused.
(3) RBSH 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. RBSH Group does not expect all facilities to be drawn, and some may lapse before drawdown.

The tables above have been prepared on the following basis:

The contractual maturity of on-balance sheet assets and liabilities above 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. 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 RBSH 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 RBSH 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.

Balance sheet management: Interest rate risk

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

RBSH 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 interest rate risk as the level of interest rates rise and fall.

RBSH 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 RBSH 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 granted by the RBSH Group Asset and Liability Committee (ALCO.) Limits on IRRBB are set according to the Non-Trading Interest Rate and Foreign Currency Risk Policy Statement and are subject to RBSH Group ALCO approval.

IRRBB is measured using a version of the same Value at Risk (VaR) methodology that is used by RBSG Group, that is, on the basis of historical simulation using two years of unweighted data. The holding period is one day and the confidence level 99%.

RBSH Group is required to manage IRRBB through transactions with RBS plc to the greatest extent possible.

Group Treasury aggregates exposures arising from its own external activities and positions transferred to it from the Regional Treasuries. Where appropriate, Group Treasury nets offsetting risk exposures to determine a residual exposure to interest rate movements. Hedging transactions using cash and derivative instruments are executed to manage the net positions according to the Non-Trading Interest Rate and Foreign Currency Risk Policy Statement and to maintain them within the RBSH Group ALCO approved VaR limits.

Residual risk positions are routinely reported to RBSH Group ALCO, RBSH Group Managing and Supervisory Board and RBSH Group RCC.

IRRBB one-day VaR at 99% confidence level for RBSH Group's retail and commercial banking activities was as follows. The figures exclude the banking books of Short Term Markets and Finance (STMF) which are reported within the Market Risk section.

	Average	Period end	Maximum	Minimum
	€m	€m	€m	€m
2011	10.0	8.3	15.2	7.4
2010	30.1	16.2	69.9	16.2
2009	50.4	39.0	75.2	32.5

Key points

- During 2011, the Greek bonds held in the RBSH Group Liquidity Portfolio were impaired and the related interest rate swaps hedging them unwound, as they were no longer in an effective hedge accounting relationship.

  - VaR reduced in 2010 following the legal separation of the Dutch State acquired businesses.

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Balance sheet management: 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 euro. RBSH Group hedges structural foreign currency exposures only in limited circumstances. RBSH Group's objective is to ensure, where practical, that its consolidated capital ratios are largely protected from the effect of changes in exchange rates.

RBSH Group seeks to limit the sensitivity to its Core Tier 1 ratio to 15 basis points in a 10% rate shock scenario. Throughout 2011, RBSH Group has met this target.

The structural foreign currency position is monitored on an ongoing basis and, if necessary, hedges are adjusted accordingly in order to ensure compliance with the Non Trading Interest Rate and Foreign Currency Risk Policy Statement and with the RBSH Group ALCO approved limits. RBSH Group's structural foreign currency position is reviewed by RBSH Group ALCO regularly.

The tables below set out RBSH Group structural foreign currency exposures.

2011	Net investments in foreign operations (1) €m	Net investment hedges €m	Structural foreign currency exposures €m
US dollar	1,334	(1,129)	205
Pound sterling	721	(715)	6
Other non-euro	3,749	(2,310)	1,439
	5,804	(4,154)	1,650
2010			
US dollar	1,271	(730)	541
Pound sterling	1,358	(1,238)	120
Other non-euro	3,779	(2,298)	1,481
	6,408	(4,266)	2,142
2009			
US dollar	768	(543)	225
Pound sterling	(873)	(72)	(945)
Other non-euro	4,064	(2,876)	1,188
	3,959	(3,491)	468

Notes:

(1) Includes minority participations.

Key points

- The GBP denominated net investments in foreign operations decreased during 2011 as a result of the transfer of eligible business carried out in the UK during 2011 as part of the UK Transfers.

Sensitivity of equity to exchange rates
Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure.

The table shows the sensitivity of RBSH Group's equity capital to a 10% appreciation and 10% depreciation in the euro against all foreign currencies.

2011 (1)		2010 (1)		2009	
Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%
€m	€m	€m	€m	€m	€m
(162)	165	(367)	435	(259)	259

Notes:
(1) The basis used to calculate the sensitivity to a percentage change in the euro against all foreign currencies was revised in line with RBSG Group methodology.

Risk management

Introduction

Risk management is conducted on an overall basis within RBSG Group. Therefore the discussion on pages 47 to 91 refer principally to policies and procedures in the RBSG Group that also apply to RBSH Group. This section focuses on each of the key types of risk that RBSH Group faces - explaining how RBSH Group manages these risks and highlighting the enhancements made as a result of progress under RBSH Group's ongoing initiatives to strengthen its approach to risk management.

Credit risk

Credit risk is the risk of financial loss due to the failure of a customer to meet its obligation to settle outstanding amounts. The quantum and nature of credit risk assumed across RBSG 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 RBSG 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 RBSG Group-wide policies, credit risk frameworks, RBSG Group-wide portfolio management and assessment of provision adequacy sits within the RBSG Group Credit Risk (GCR) function under the management of the RBSG Group Chief Credit Officer. Execution of these policies and frameworks is the responsibility of the risk management functions, located within the RBSG Group's business divisions. These divisional credit risk functions work together with GCR to ensure that RBSG Groups 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 RBSG 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 RBSH Group with all RBSG Group credit policies.

Risk appetite

RBSH Group's credit concentration risk is managed and controlled through a series of frameworks designed to limit concentration by product/asset class, sector, counterparty or country. These are supported by a suite of RBSG Group-wide and divisional policies setting out the risk parameters within which business units may operate. Information on RBSH Group's credit portfolios is reported to the RGSH Group Managing Board via the RBSH Group Risk and Control Committee on a regular basis.

In the two years since the new concentration framework was rolled out across the RBSG Group, the RBSG Group Executive Risk Forum (ERF) has reviewed all material industry and product portfolios and agreed a risk appetite commensurate with the franchises represented in these reviews. The product/asset class, single name, sector and country limits are now firmly embedded in the risk management processes of RBSH Group's risk appetite framework, which is regularly reviewed to ensure limits and measurement triggers remain adequate for monitoring purposes.

Product/asset class concentration framework

- Retail - a formal framework establishes RBSG Group-level statements and thresholds that are cascaded through all retail franchises in RBSG 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 RBSG Group standards and appetite. This appetite setting and tracking then inform 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 RBSG Group, where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. Those portfolios identified as potentially representing a concentration or heightened risk are subject to formal governance, including periodic review, at either RBSG Group or at RBSH Group level, depending on materiality.

Risk management: Credit risk continued

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 reviews are undertaken at RBSG Group or at RBSH Group level depending on materiality.

These may include an assessment of RBSG 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 RBSH Group's sector risk exposure is provided to senior management and the RBSH Group Managing Board.

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. RBSH Group's exposures to these banks continue to be closely managed. The increased use of central clearing houses to reduce 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 RBSH 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 RBSG Group-wide authority grid. Whilst both parties are accountable for the quality of each decision taken, the credit risk management approver holds ultimate sanctioning authority. The level of authority granted to individuals is dependent on their experience and expertise with only a small number of senior executives holding the highest authority provided under the framework. Daily monitoring of individual counterparty limits is undertaken.

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

Since 2009, RBSH Group has been managing its corporate exposures to reduce concentrations and align its appetite for business to RBSG Group's broader strategies for its large corporate franchises. In the last quarter of 2011, RBSG

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 RBSG Group to differentiate more consistently, between the different risk types. These changes will be implemented during the first quarter of 2012. RBSG 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 RBSG 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. 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 RBSH Group manages credit risk by country, refer to the Country risk section on page 74.

Controls and assurance

A strong independent assurance function is an important element of a sound control environment. During 2011, RBSG Group took the decision to strengthen its credit quality assurance (CQA) activities and moved all divisional CQA resources under the centralised management of RBSG Group Credit Risk. The benefits of this action are already visible 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 RBSG Group's key credit policies. This will ensure that RBSG Group's control environment is appropriately aligned to the risk appetite statements that the RBSG Board and the Managing Board has approved and provide a sound basis for RBSG 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 RBSG Group Credit Risk function launched an assurance process to provide the RBSG Group Chief Credit Officer with additional evidence on the effectiveness of the controls in place across RBSG Group to manage risk. The results of these reviews will be provided to the RBSG Group Executive Risk Forum and to the RBSG Board Risk Committee on a regular basis in support of the self-certification that RBSG Group Credit Risk is obliged to complete under the RBSG Group Policy Framework (refer to Operational risk on pages 86-87).

Risk management: Credit risk continued

Problem debt management

RBSG Group's procedures for managing problem and potential problem debts for wholesale customers are 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 of 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 weaknesses flagged warrant placing the customers on Watchlist (see 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 RBSG 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.

As at 31 December 2011, exposures to customers reported as Watchlist Red and managed within RBSH Group's divisions totalled €1.1 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.

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.

RBSG Global Restructuring Group

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

As 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 band) totalled €1.3 billion across property, transport and other sectors. The internal asset quality bands are defined on page 58.

Types of wholesale restructurings

A number of options are available to RBSH Group when corrective action is deemed necessary. RBSH 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.

Risk management: Credit risk continued
Problem debt management continued
RBSG Global Restructuring Group continued
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 RBSH 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 customer liquidity. Such concessions often depend on the expectation that liquidity will recover when market conditions improve or when a capital raising is completed, providing access to alternative sources of liquidity. Recently, these types of concessions have become more common in commercial real estate transactions, particularly in situations when 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 other forms of restructuring strategies are unlikely to succeed in isolation and the customer is incapable of servicing current debt obligations. Debt forgiveness is often an element in leveraged finance transactions which are typically structured on the basis of projected cash flows from operational activities, rather than underlying tangible asset values. Maintaining the business as a going concern with a sustainable level of debt is the preferred option rather than realising the value of the underlying assets, provided that the underlying business model and strategy are considered viable.

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

Provisioning for impaired loans
Any type 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 divisions.

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.

For more information on provisions for impairment charges, refer to page 70.

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 controls of assets - where RBSH Group holds underlying collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. RBSH 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.

Credit risk mitigation

RBSH 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.

Risk management: Credit risk continued
Credit risk mitigation continued
The use and approach to credit risk mitigation varies by product type, customer and business strategy. Minimum standards applied across RBSG 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 (e.g. 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, RBSH Group has recourse to various types of collateral and other credit enhancements to mitigate credit risk and reduce the loss to RBSH 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.

Corporate exposures
The type of collateral taken by RBSH 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 - RBSH 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, RBSH 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.

RBSH 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.

RBSH 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. RBSH Group’s business and credit teams are supported by in-house specialist documentation teams.

The existence of collateral has an impact on provisioning. Where RBSH 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.

Risk management: Credit risk continued

Credit risk mitigation continued

Wholesale markets exposures

RBSH 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 supported by legal opinions are used for financial collateral taken as part of trading activities.

	2011 (1)	2010 (1)	2009 (1)
	€bn	€bn	€bn
Reverse repurchase agreements	9.4	8.2	15.6
Securities received as collateral	9.4	8.1	7.3
Derivative assets gross exposure (2)	19.1	28.3	57.4
Counterparty netting	(0.8)	(2.9)	(7.2)

Notes:

(1) Measured on a loans and advances basis.

(2) Cash collateral held against derivative exposures in 2011 was €1.0 billion (2010 - €1.8 billion).

Credit risk measurement

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

Probability of default/customer credit grade (PD)

These models assess the probability that a customer will fail to make full and timely repayment of 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 RBSG 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 RBSH Group, on a credit facility in the event of default. RBSH 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, plus the cost of collections and a time discount factor for the delay in cash recovery.

Risk management: Credit risk continued

Balance sheet analysis
The following tables provide an analysis of credit concentration of financial assets by sector, geography and internal credit quality gradings.

Credit concentration: Sector and geographical region
The tables below and on pages 53 to 57 analyse total financial assets by sector and geographical region. Geographical regions are based on the location of office.

Sector concentration
The tables below analyse total financial assets gross of provisions by sector.

2011	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Central and local government	1,062	11,405	103	50	12,620	-
Finance (3)	32,187	28,391	16,774	1,173	78,525	3,064
Residential mortgages	1,125	-	-	-	1,125	-
Personal lending	318	-	-	-	318	-
Property	701	-	125	-	826	-
Construction	1,049	25	109	-	1,183	-
Manufacturing	7,200	21	554	-	7,775	-
Service industries and business activities	14,144	2,313	1,373	224	18,054	43
Agriculture, forestry and fishing	123	-	98	-	221	-
Finance lease and instalment credit	102	-	2	-	104	-
Interest accruals	192	583	-	-	775	-
Total gross of provisions	58,203	42,738	19,138	1,447	121,526	3,107
Provisions	(1,572)	-	-	-	(1,572)	
Total	56,631	42,738	19,138	1,447	119,954	3,107
Comprising:						
Derivative balances						813
Derivative collateral						2,256
Other						38
						3,107
2010						
Central and local government	1,544	26,038	383	7	27,972	-
Finance (3)	39,786	45,413	25,194	3,858	114,251	7,865
Residential mortgages	984	-	-	-	984	-
Personal lending	427	72	-	-	499	-
Property	1,110	53	142	-	1,305	-

Construction	921	46	47	-	1,014	-
Manufacturing	9,213	170	404	-	9,787	-
Service industries and business activities	18,297	1,874	2,102	-	22,273	2
Agriculture, forestry and fishing	165	-	-	-	165	-
Finance lease and instalment credit	54	-	-	-	54	-
Interest accruals	272	1,228	-	-	1,500	-
Total gross of provisions	72,773	74,894	28,272	3,865	179,804	7,867
Provisions	(1,572)	-	-	-	(1,572)	-
Total	71,201	74,894	28,272	3,865	178,232	7,867

For notes to this table refer to page 57.

Risk management: Credit risk continued
Balance sheet analysis continued
Sector and geographical region continued

2009	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Central and local government	2,624	48,596	100	37	51,357	3
Finance (3)	74,289	40,862	50,984	2,550	168,685	7,243
Residential mortgages	102,687	14	259	-	102,960	-
Personal lending	3,017	-	196	1	3,214	45
Property	5,323	517	484	119	6,443	-
Construction	1,426	413	22	20	1,881	-
Manufacturing	19,890	1,806	2,838	115	24,649	74
Service industries and business activities	47,504	8,249	1,639	911	58,303	33
Agriculture, forestry and fishing	5,202	269	23	10	5,504	-
Finance lease and instalment credit	19	14	-	-	33	-
Interest accruals	1,407	1,296	847	2	3,552	-
Total gross of provisions	263,388	102,036	57,392	3,765	426,581	7,398
Provisions	(5,711)	-	-	-	(5,711)	-
Total	257,677	102,036	57,392	3,765	420,870	7,398

For notes to this table refer to page 57.

Loans and advances to banks and customers by geographical region
The table below analyses loans and advances net of provisions by geographical region (location of office).

	2011 €m	2010 €m	2009 €m
Loans and advances to banks			
Netherlands	8,648	6,072	9,910
US	1,458	280	42
Rest of world	16,947	20,353	27,767
	27,053	26,705	37,719
Loans and advances to customers			
Netherlands	6,164	9,621	155,033
US	874	1,531	4,078
Rest of world	22,540	33,344	60,847
	29,578	44,496	219,958
Total	56,631	71,201	257,677

Risk management: Credit risk continued
Balance sheet analysis continued
Sector and geographical region continued
The tables below analyses total financial assets net of provisions, by geographical region and sector.

2011	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	120	5,411	-	-	5,531	-
Finance	9,789	25,528	2,933	10	38,260	-
Residential mortgages	410	-	-	-	410	-
Personal lending	-	-	-	-	-	-
Property	233	-	6	-	239	-
Construction	551	-	-	-	551	-
Manufacturing	804	-	-	-	804	-
Service industries and business activities	2,856	364	51	-	3,271	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	49	513	-	-	562	-
Total net of provisions	14,812	31,816	2,990	10	49,628	-
US						
Central and local government	13	1,125	-	-	1,138	-
Finance	1,586	41	4	465	2,096	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	6	-	-	-	6	-
Construction	-	-	-	-	-	-
Manufacturing	324	-	-	-	324	-
Service industries and business activities	399	-	31	-	430	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	4	-	-	-	4	-
Total net of provisions	2,332	1,166	35	465	3,998	-
Rest of World						
Central and local government	929	4,869	103	50	5,951	-
Finance	20,108	2,822	13,837	698	37,465	3,064
Residential mortgages	656	-	-	-	656	-
Personal lending	249	-	-	-	249	-
Property	357	-	119	-	476	-
Construction	485	25	109	-	619	-

Manufacturing	5,832	21	554	-	6,407	-
Service industries and business activities	10,509	1,949	1,291	224	13,973	43
Agriculture, forestry and fishing	121	-	98	-	219	-
Finance lease and instalment credit	102	-	2	-	104	-
Interest accruals	139	70	-	-	209	-
Total net of provisions	39,487	9,756	16,113	972	66,328	3,107

For notes to this table refer to page 57.

Risk management: Credit risk continued
Balance sheet analysis continued
Sector and geographical region continued

2010	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	372	19,081	-	-	19,453	-
Finance	7,671	18,900	3,550	28	30,149	-
Residential mortgages	425	-	-	-	425	-
Personal lending	6	72	-	-	78	-
Property	245	49	24	-	318	-
Construction	388	7	2	-	397	-
Manufacturing	1,745	90	1	-	1,836	-
Service industries and business activities	4,703	763	68	-	5,534	-
Agriculture, forestry and fishing	65	-	-	-	65	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	73	661	-	-	734	-
Total net of provisions	15,693	39,623	3,645	28	58,989	-
US						
Central and local government	163	34	-	-	197	-
Finance	472	109	-	402	983	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	18	-	-	-	18	-
Construction	2	-	-	-	2	-
Manufacturing	606	-	-	-	606	-
Service industries and business activities	540	21	33	-	594	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	10	-	-	-	10	-
Total net of provisions	1,811	164	33	402	2,410	-
Rest of World						
Central and local government	1,007	6,923	383	7	8,320	-
Finance	31,117	26,404	21,644	3,428	82,593	7,865
Residential mortgages	533	-	-	-	533	-
Personal lending	240	-	-	-	240	-
Property	780	4	118	-	902	-
Construction	522	39	45	-	606	-

Manufacturing	6,599	80	403	-	7,082	-
Service industries and business activities	12,558	1,090	2,001	-	15,649	2
Agriculture, forestry and fishing	98	-	-	-	98	-
Finance lease and instalment credit	54	-	-	-	54	-
Interest accruals	189	567	-	-	756	-
Total net of provisions	53,697	35,107	24,594	3,435	116,833	7,867

For notes to this table refer to page 57.

Risk management: Credit risk continued
Balance sheet analysis continued
Sector and geographical region continued

2009	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Netherlands						
Central and local government	1,658	38,403	16	-	40,077	-
Finance	21,630	27,670	5,770	13	55,083	-
Residential mortgages	101,988	-	259	-	102,247	-
Personal lending	169	-	194	-	363	-
Property	3,839	15	374	4	4,232	-
Construction	848	-	6	1	855	-
Manufacturing	5,470	23	76	-	5,569	-
Service industries and business activities	23,740	351	1,001	59	25,151	-
Agriculture, forestry and fishing	4,814	32	23	-	4,869	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	787	-	847	-	1,634	-
Total net of provisions	164,943	66,494	8,566	77	240,080	-
US						
Central and local government	92	19	-	-	111	-
Finance	334	105	22	370	831	-
Residential mortgages	-	-	-	-	-	-
Personal lending	-	-	-	-	-	-
Property	69	-	-	-	69	-
Construction	-	-	-	-	-	-
Manufacturing	1,723	25	-	-	1,748	-
Service industries and business activities	1,888	-	34	-	1,922	-
Agriculture, forestry and fishing	-	-	-	-	-	-
Finance lease and instalment credit	-	-	-	-	-	-
Interest accruals	14	-	-	-	14	-
Total net of provisions	4,120	149	56	370	4,695	-
Rest of World						
Central and local government	873	10,174	85	37	11,169	3
Finance	51,736	13,087	45,191	2,167	112,181	7,243
Residential mortgages	-	14	-	-	14	-
Personal lending	2,848	-	2	1	2,851	45
Property	1,267	502	110	115	1,994	-
Construction	542	412	16	19	989	-
Manufacturing	10,369	1,758	2,762	115	15,004	74
Service industries and business activities	20,098	7,898	604	852	29,452	33

Agriculture, forestry and fishing	255	237	-	10	502	-
Finance lease and instalment credit	19	14	-	-	33	-
Interest accruals	607	1,296	-	2	1,905	-
Total net of provisions	88,614	35,392	48,770	3,318	176,094	7,398

Notes:

(1) Includes settlement balances.

(2) This shows the amount by which RBSH Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give RBSH Group a legal right to set off the financial asset against a financial liability due to the same counterparty. In addition, RBSH 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. RBSH 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) Includes reverse repurchase agreements of €9.4 billion (2010 - €8.2 billion; 2009 - €15.6 billion)

Risk management: Credit risk continued
Balance sheet analysis continued
Asset quality
The asset quality analysis presented below is based on RBSG 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 RBSG Group map to both a RBSG 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 agencies and are therefore excluded from the table below and set out on page 59.

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 €m	Loans and advances to customers €m	Settlement balances €m	Derivatives €m	Other financial instruments €m	Commitments €m	Contingent liabilities €m	Total €m
AQ1	12,184	9,982	7,257	81	4,267	-	8,565	9,529	51,865
AQ2	157	322	2,533	-	1,091	-	4,052	2,543	10,698
AQ3	206	407	3,760	614	1,032	-	2,895	2,853	11,767
AQ4	-	406	6,811	8	801	-	3,657	3,155	14,838
AQ5	55	498	3,039	45	461	-	1,280	1,865	7,243

AQ6	-	84	2,061	-	55	-	383	404	2,987
AQ7	-	382	1,965	1	99	-	328	519	3,294
AQ8	7	12	356	-	236	-	20	28	659
AQ9	-	91	842	-	4	-	857	1,003	2,797
AQ10	-	2	218	4	30	-	276	26	556
Balances with RBSG Group	-	14,858	-	1,855	11,062	-	65	1,272	29,112
Past due	-	2	385	-	-	-	-	-	387
Impaired	-	52	1,878	-	-	494	-	-	2,424
Impairment provision	-	(45)	(1,527)	-	-	(31)	-	-	(1,603)
Total	12,609	27,053	29,578	2,608	19,138	463	22,378	23,197	137,024
2010									
AQ1	7,923	12,758	11,047	3,174	12,200	235	13,289	4,844	65,470
AQ2	15	587	2,620	122	1,444	-	3,622	1,217	9,627
AQ3	53	732	4,431	11	1,140	-	4,168	2,687	13,222
AQ4	216	565	9,001	(1)	1,402	-	7,604	4,114	22,901
AQ5	111	2,502	7,069	5	945	-	4,066	1,757	16,455
AQ6	-	170	2,956	1	80	-	943	275	4,425
AQ7	-	131	2,973	-	229	-	1,129	1,725	6,187
AQ8	-	-	794	-	135	-	2,126	10,786	13,841
AQ9	-	118	1,333	-	193	-	319	509	2,472
AQ10	5	89	1,373	2	257	-	726	170	2,622
Balances with RBSG Group	-	9,039	128	259	10,247	-	2	661	20,336
Past due	-	4	190	-	-	-	-	-	194
Impaired	-	55	2,108	-	-	434	-	-	2,597
Impairment provision	-	(45)	(1,527)	-	-	(33)	-	-	(1,605)
Total	8,323	26,705	44,496	3,573	28,272	636	37,994	28,745	178,744

Business review continued

Business Review
Risk and balance sheet management

Risk management: Credit risk continued
Balance sheet analysis continued
Asset quality continued

2009	Cash and balances at central banks €m	Loans and advances to banks €m	Loans and advances to customers €m	Settlement balances €m	Derivatives €m	Other financial instruments €m	Commitments €m	Contingent liabilities €m	Total €m
AQ1	28,382	22,775	21,047	3,298	20,343	370	6,676	4,762	107,653
AQ2	-	1,100	6,085	-	1,313	-	5,872	4,190	18,560
AQ3	-	309	10,762	-	694	-	5,911	4,219	21,895
AQ4	-	670	45,156	-	3,576	-	18,736	13,372	81,510
AQ5	-	3,156	55,390	-	3,091	-	6,693	4,776	73,106
AQ6	-	423	23,592	-	438	-	1,664	1,187	27,304
AQ7	-	96	24,366	-	445	-	1,855	1,325	28,087
AQ8	-	179	13,644	-	226	-	1,577	1,125	16,751
AQ9	-	267	10,480	-	247	-	1,902	1,358	14,254
AQ10	-	89	2,873	-	82	-	634	452	4,130
Balances with RBSG Group	-	8,611	1,602	100	26,937		-	1	37,251
Past due	-	-	2,626	-	-	-	-	-	2,626
Impaired	-	119	7,971	-	-	-	-	-	8,090
Impairment provision	-	(75)	(5,636)	-	-	-	-	-	(5,711)
Total	28,382	37,719	219,958	3,398	57,392	370	51,520	36,767	435,506

Debt securities

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

2011	Central and local government								
	UK €m	US €m	Other €m	Banks €m	Other financial institutions €m	Corporate €m	Total €m	Total %	Of which ABS (1) €m
AAA	-	-	5,564	2,821	6,285	175	14,845	37.4%	8,755
AA to AA+	-	3,521	1,882	1,215	1,633	57	8,308	21.0%	2,347
A to AA-	-	-	4,846	2,398	1,839	4	9,087	22.9%	3,727
BBB- to A-	-	-	2,504	2,213	484	82	5,283	13.3%	2,383
Non-investment grade	-	-	803	477	349	205	1,834	4.7%	150
Unrated	-	-	2	93	30	163	288	0.7%	-
Total	-	3,521	15,601	9,217	10,620	686	39,645	100.0%	17,362

2010									
AAA	7	2,328	15,405	6,775	7,901	404	32,820	62.7%	14,466
AA to AA+	-	-	929	1,221	2,498	155	4,803	9.2%	2,978
A to AA-	-	-	3,784	944	40	95	4,863	9.3%	824
BBB- to A-	-	-	3,031	628	31	54	3,744	7.2%	49
Non-investment grade	-	-	1,682	1,670	443	1,564	5,359	10.3%	5
Unrated	-	-	-	134	214	323	671	1.3%	67
Total	7	2,328	24,831	11,372	11,127	2,595	52,260	100.0%	18,389
2009									
AAA	879	4,635	26,412	12,970	13,588	534	59,018	69.6%	23,367
BBB- to AA+	-	-	17,094	465	3,660	1,791	23,010	27.1%	949
Non-investment grade	-	-	194	-	456	332	982	1.2%	59
Unrated	-	-	524	-	459	807	1,790	2.1%	20
Total	879	4,635	44,224	13,435	18,163	3,464	84,800	100.0%	24,395

Notes:

(1) Asset-backed securities.

Risk management: Credit risk continued
Balance sheet analysis continued
Asset-backed securities (ABS)
RBSH Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets.

The table below analyses the carrying value of RBSH Group's debt securities.

	2011 €bn	2010 €bn	2009 €bn
Securities issued by central and local governments	19.1	27.2	49.7
Securities issued by corporates	0.7	2.6	3.5
Securities issued by banks and other financial institutions	19.8	22.5	31.6
	39.6	52.3	84.8
Asset-backed securities	17.4	18.4	24.4

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

ABS include residential mortgage backed securities (RMBS), commercial mortgage backed securities (CMBS), collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and other ABS. In many cases the risk on these assets is hedged by way of credit derivative protection purchased over the specific asset or relevant ABS indices. The counterparties to some of these hedge transactions are monoline insurers.

The following tables summarise RBSH Group's net exposures and carrying values of these securities by geography of the underlying assets at 31 December 2011, 2010 and 2009. Gross exposures represent the principal amounts relating to ABS. Government sponsored or similar RMBS comprises securities that are: (a) guaranteed or effectively guaranteed by the US government, by way of its support for US federal agencies and government sponsored enterprises, or (b) guaranteed by the Dutch government. Net exposures represent the carrying value after taking account of the hedge protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

Asset-backed securities by product, geography and measurement classification

2011	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP (2) HFT (3) €m	AFS (4) €m	LAR (5) €m
Gross exposure								
	-	-	7,035	-	7,035	-	7,035	-

RMBS: government sponsored or similar								
MBS: covered bond	160	242	9,870	-	10,272	-	10,272	-
CDOs	-	-	184	-	184	-	184	-
Other ABS	-	-	1,603	25	1,628	-	1,628	-
	160	242	18,692	25	19,119	-	19,119	-
Net exposure								
RMBS: government sponsored or similar	-	-	6,635	-	6,635	-	6,635	-
MBS: covered bond	162	250	8,578	-	8,990	-	8,990	-
CDOs	-	-	165	-	165	-	165	-
Other ABS	-		1,547	25	1,572	-	1,572	-
	162	250	16,924	25	17,362	-	17,362	-

For notes relating to this table refer to page 61.

Risk management: Credit risk continued
Balance sheet analysis continued
Asset-backed securities by product, geography and measurement classification continued

2010	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP (2) HFT (3) €m	AFS (4) €m	LAR (5) €m
Gross exposure								
RMBS: government sponsored or similar	-	-	7,449	-	7,449	-	7,449	-
MBS: covered bond	160	242	9,887	-	10,289	-	10,289	-
CDOs	-	-	163	-	163	9	154	-
Other ABS	-	-	2,229	31	2,260	-	2,260	-
	160	242	19,728	31	20,161	9	20,152	-
Net exposure								
RMBS: government sponsored or similar	-	-	6,909	-	6,909	-	6,909	-
MBS: covered bond	164	242	8,724	-	9,130	-	9,130	-
CDOs	-	-	146	-	146	-	146	-
Other ABS	-	-	2,173	31	2,204	-	2,204	-
	164	242	17,952	31	18,389	-	18,389	-

2009	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP (2) HFT (3) €m	AFS (4) €m	LAR (5) €m
Gross exposure								
RMBS: government sponsored or similar	-	-	7,902	106	8,008	106	7,902	-
MBS: covered bond	55	335	10,786	-	11,176	-	11,176	-
RMBS: prime	-	183	3,165	4	3,352	3,352	-	-
RMBS: sub-prime	-	-	-	9	9	-	9	-
CDOs	5	148	238	-	391	8	235	148
Other ABS	-	-	2,849	29	2,878	429	2,449	-
	60	666	24,940	148	25,814	3,895	21,771	148
Net exposure								
RMBS: government sponsored or similar	-	-	7,736	37	7,773	37	7,735	-
MBS: covered bond	56	324	10,490	-	10,870	-	10,870	-
RMBS: prime	-	168	2,850	4	3,022	3,022	-	-
RMBS: sub-prime	-	-	-	9	9	-	9	-
CDOs	-	58	200	-	258	-	200	58
Other ABS	-	-	2,434	29	2,463	20	2,443	-
	56	550	23,709	79	24,395	3,079	21,257	58

Notes:
(1) Rest of World
(2) Designated as at fair value through profit or loss
(3) Held-for-trading
(4) Available-for-sale
(5) Loans and receivables

Risk management: Credit risk continued
Balance sheet analysis continued
Asset-backed securities by product, geography and measurement classification continued
The table below summarises the rating levels of ABS carrying values. Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto the S&P scale.

2011	AAA €m	AA to AA+ €m	A to AA- €m	BBB- to A- €m	Non-investment grade €m	Unrated €m	Total €m
RMBS: government sponsored or similar	4,979	1,474	157	-	25	-	6,635
MBS: covered bond	3,102	454	3,069	2,365	-	-	8,990
CDOs	-	-	22	18	125	-	165
Other ABS	674	419	479	-	-	-	1,572
	8,755	2,347	3,727	2,383	150	-	17,362
2010							
RMBS: government sponsored or similar	5,136	1,774	-	-	-	-	6,910
MBS: covered bond	8,241	414	474	-	-	-	9,129
CDOs	-	-	127	19	-	-	146
Other ABS	1,089	790	223	30	5	67	2,204
	14,466	2,978	824	49	5	67	18,389
2009							
RMBS: government sponsored or similar	7,635	138	-	-	-	-	7,773
MBS: covered bond	10,389	406	75	-	-	-	10,870
RMBS: prime	3,022	-	-	-	-	-	3,022
RMBS: sub-prime	9	-	-	-	-	-	9
CDOs	199	-	-	-	59	-	258
Other ABS	2,113	301	-	29	-	20	2,463
	23,367	845	75	29	59	20	24,395

Key points

- Carrying values of asset-backed securities decreased by €1 billion during 2011 due to the maturity and sale of positions.

- The RMBS held for trading positions fully matured or were sold off in 2010. The composition of the remaining AFS portfolio has not changed substantially since 31 December 2010. The available-for-sale RMBS government sponsored or similar positions are backed by mortgages covered by the Dutch mortgage guarantee scheme.

- The available-for-sale MBS covered bond positions originated largely in Europe and relate mostly to Spanish securities.

Non-investment grade and unrated ABS
The table below summarises the carrying values by accounting classification of ABS rated as non-investment grade or not publicly rated.

	Non-investment grade				Unrated			
	HFT	AFS	LAR	Total	HFT	AFS	LAR	Total
2011	€m	€m	€m	€m	€m	€m	€m	€m
CDOs	-	125	-	125	-	-	-	-
Other ABS	-	25	-	25	-	-	-	-
	-	150	-	150	-	-	-	-
2010								
Other ABS	-	5	-	-	-	67	-	72
2009								
CDOs	-	-	58	-	-	-	-	58
Other ABS	-	-	-	-	20	-	-	20
	-	-	58	-	20	-		78

Business review continued

Business Review
Risk and balance sheet management

Risk management: Credit risk continued
Balance sheet analysis continued
Derivatives
RBSH Group's derivative assets by internal grading scale and residual maturity are analysed below. Master netting agreements in respect of mark-to-market (mtm) positions and collateral shown below do not result in a net presentation in the RBSH Group's balance sheet under IFRS.

	2011						2010					
	0 - 3 months	3 - 6 months	6 - 12 months	1 - 5 years	Over 5 years	Gross assets	0 - 3 months	3 - 6 months	6 - 12 months	1 - 5 years	Over 5 years	Gross assets
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
AQ1	605	448	563	1,530	1,121	4,267	1,745	428	1,741	5,163	3,123	12,200
AQ2	49	24	51	406	561	1,091	76	7	73	983	305	1,444
AQ3	117	166	116	119	514	1,032	189	63	90	493	305	1,140
AQ4	110	60	99	106	426	801	531	51	110	585	125	1,402
AQ5	104	21	64	253	19	461	538	12	44	203	148	945
AQ6	8	2	8	26	11	55	13	5	10	45	7	80
AQ7	19	11	19	22	28	99	14	19	9	121	66	229
AQ8	-	-	-	6	230	236	1	-	7	36	91	135
AQ9	-	-	1	3	-	4	105	3	1	44	40	193
AQ10	5	3	-	21	1	30	182	-	10	33	32	257
Balances with RBSG Group	802	411	1,101	4,660	4,088	11,062	2,212	529	513	5,458	1,535	10,247
	1,819	1,146	2,022	7,152	6,999	19,138	5,606	1,117	2,608	13,164	5,777	28,272
Counterparty mtm netting						(813)						(2,864)
Cash collateral held against derivative exposures						(1,033)						(1,786)
Net exposure						17,292						23,622

The tables below analyse RBSH Group's derivative assets by contract type and residual maturity and the effect of position netting and collateral.

Contract type	0 - 3 months €m	3 - 6 months €m	6 - 12 months €m	1 - 5 years €m	Over 5 years €m	Gross assets €m	Counterparty mtm netting €m	Net Exposure €m
2011								
Exchange rate	1,102	621	1,127	2,005	1,678	6,533	(48)	6,485
Interest rate	205	95	495	2,632	3,756	7,183	(579)	6,604
Credit derivatives	13	2	8	95	595	713	(28)	685
Equity and commodity	499	429	392	2,419	970	4,709	(158)	4,551
	1,819	1,147	2,022	7,151	6,999	19,138		18,325
Cash collateral held against derivative exposures								(1,033)
Net exposure								17,292

2010

Exchange rate	2,018	629	777	3,182	1,139	7,745	(389)	7,356
Interest rate	2,297	187	327	6,008	3,806	12,625	(1,399)	11,226
Credit derivatives	514	3	32	372	676	1,597	(1,076)	521
Equity and commodity	777	298	1,472	3,602	156	6,305	-	6,305
	5,606	1,117	2,608	13,164	5,777	28,272		25,408
2009								
Exchange rate	3,276	1,329	1,780	6,372	3,193	15,950	(1,821)	14,129
Interest rate	402	349	1,672	14,930	13,197	30,550	(1,728)	28,822
Credit derivatives	140	1	14	1,293	2,226	3,674	(1,255)	2,419
Equity and commodity	1,830	578	1,336	3,165	309	7,218	(2,431)	4,787
	5,648	2,257	4,802	25,760	18,925	57,392		50,157

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Risk management: Credit risk continued
Balance sheet analysis continued
Credit derivatives
RBSH Group trades credit derivatives as part of its client led business and to mitigate credit risk. RBSH Group's credit derivative exposures relating to proprietary trading are minimal. The table below analyses RBSH Group's bought and sold protection by purpose. Credit derivatives with RBSG Group are excluded from the table below.

	2011				2010			
	Notional		Fair value		Notional		Fair value	
	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold
	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn
Client led trading and residual risk	701	185	(1)	(2)	3,403	45	(45)	(1)
Credit hedging – banking book	1,088	460	(16)	3	9,129	20,337	(153)	94
Credit hedging – trading book								
- Credit and mortgage markets	2,348	2,461	193	382	10,216	3,648	2,186	1,308
- Other	194	-	(66)	-	384	27	(19)	-
	4,331	3,106	110	383	23,132	24,057	1,969	1,401

Risk management: Credit risk continued
Balance sheet analysis continued
Monoline insurers

The table below summarises RBSH Group's exposure to monolines; all of which are in Non-Core.	2011 €m	2010 €m	2009 €m
Gross exposure to monolines	265	2,600	2,913
Hedges with financial institutions (including an overlay swap with RBSG Group)	(43)	(695)	(806)
Credit valuation adjustment	(222)	(1,905)	(2,107)
Net exposure to monolines	-	-	-
Credit valuation adjustment as a % of gross exposure	84%	73%	72%
Credit risk RWAs	50,195	64,200	115,953

- The exposure to monolines reduced primarily due to the restructuring of some exposures, partially offset by lower prices of underlying reference instruments. The credit valuation adjustments decreased due to the reduction in exposure partially offset by wider credit spreads.
- The €43 million hedges with financial institutions include the overlay swap transacted with RBSG Group which transfers the daily movement in the CVA between RBSH Group and RBSG Group for these trades.

The net income statement effect relating to monoline exposures is shown below.

	2011 €m	2010 €m	2009 €m
Credit valuation adjustment at 1 January	(1,905)	(2,107)	(2,822)
Credit valuation adjustment at 31 December	(222)	(1,905)	(2,107)
Decrease/(increase) in credit valuation adjustment	1,683	202	715
Net (debit) relating to realisation, hedges, foreign exchange and other movements	(1,689)	(180)	(1,994)
Net (debit)/credit to income statement	(6)	22	(1,279)

Risk management: Credit risk continued
Balance sheet analysis continued
Cross border exposures
Cross border exposures are loans and advances including finance leases and instalment credit receivables and other monetary assets, such as debt securities and net derivatives, including non-local currency claims of overseas offices on local residents.

RBSH 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 RBSH Group's cross border exposures greater than 0.5% of RBSH Group's total assets.

	2011				2010	2009
	Government	Banks	Other	Total	Total	Total
	€m	€m	€m	€m	€m	€m
United States	3,549	752	9,685	13,986	13,612	16,844
Spain	43	3,159	5,413	8,615	8,188	17,913
Germany	4,683	1,821	504	7,008	9,750	16,725
India	23	68	5,785	5,876	4,611	2,930
France	1,980	758	1,584	4,322	4,853	12,814
China	305	1,955	1,517	3,777	3,089	1,859 *
Australia	-	118	2,694	2,812	422 *	624 *
Italy	1,739	56	697	2,492	1,932	6,135
Republic of Korea	-	948	1,274	2,222	2,919	2,276 *
Turkey	176	173	1,481	1,830	1,667	2,022 *
Belgium	981	107	568	1,656	2,042	5,115
Hong Kong	33	230	1,148	1,411	1,618	1,568 *
Romania	62	26	1,276	1,364	942 *	1,113 *
Singapore	-	79	1,261	1,340	683 *	1,184 *
Canada	13	154	1,156	1,323	546 *	351 *
Brazil	826	145	252	1,223	1,110	461 *
Greece	545	44	516	1,105	1,313	3,595
Russian Federation	-	456	542	998	2,034	1,706 *
Luxembourg	32	106	837	975	1,838	4,147
Mexico	-	122	753	875	1,119	1,174 *
Denmark	-	203	598	801	411 *	622 *

* Less than 0.5% of Group total assets.

Risk management: Credit risk continued
Risk elements in lending, loans and reserves
Risk elements in lending (REIL) comprises impaired loans and accruing loans past due 90 days or more as to principal or interest.

Impaired loans comprise all loans for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans.

Loans are classified as accruing loans past due 90 days or more where they are past due 90 days but where no impairment provision is recognised. This category is used for fully collateralised non revolving credit facilities.

	2011			2010			2009
	Core	Non-Core	Total	Core	Non-Core	Total	Total
	€m	€m	€m	€m	€m	€m	€m
Impaired loans							
- Domestic	92	247	339	133	312	445	5,398
- Foreign	766	825	1,591	541	1,178	1,719	2,691
	858	1,072	1,930	674	1,490	2,164	8,089
Accruing loans past due 90 days or more							
- Domestic	78	-	78	48	3	51	92
- Foreign	83	6	89	5	4	9	61
	161	6	167	53	7	60	153
Total REIL	1,019	1,078	2,097	727	1,497	2,224	8,242
REIL as a % of gross loans and advances			6.8 %			4.8 %	3.7 %

Potential problem loans
Potential problem loans (PPL) are loans for which an impairment event has taken place but no impairment provision is required. This category is used for fully collateralised advances which are not past due 90 days or revolving credit facilities where identification as 90 days overdue is not feasible.

	2011	2010	2009
	€m	€m	€m
Potential problem loans	220	133	532

Both REIL and PPL are reported gross and take no account of the value of any security held which could reduce the eventual loss should it occur, nor of any provision marked. Therefore impaired assets which are highly collateralised, such as mortgages, will have a low coverage ratio of provisions held against the reported impaired balance.

Risk management: Credit risk continued
Balance sheet analysis continued
Risk elements in lending, loans and reserves continued
Movement in REIL and PPL
The table below details the movement in REIL during the year ended 31 December 2011.

	Impaired loans			Other loans (1)			REIL		
	Core	Non-Core	Total	Core	Non-Core	Total	Core	Non-Core	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m
At 1 January 2011	686	1,478	2,164	54	6	60	740	1,484	2,224
Currency translation and other adjustments	(5)	59	54	-	-	-	(5)	59	54
Additions	420	200	620	78	216	294	498	416	914
Transfers	(53)	-	(53)	170	(58)	112	117	(58)	59
Disposals and restructurings	(4)	(211)	(215)	-	7	7	(4)	(204)	(208)
Repayments	(125)	(144)	(269)	(141)	(165)	(306)	(266)	(309)	(575)
Amounts written-off	(61)	(310)	(371)	-	-	-	(61)	(310)	(371)
At 31 December 2011	858	1,072	1,930	161	6	167	1,019	1,078	2,097

Notes:

(1) Accruing loans past due 90 days or more (also see below).

Past due analysis
The following loans and advances to customers that were past due at the balance sheet date but not considered impaired.

	2011			2010			2009
	Core	Non-Core	Total	Core	Non-Core	Total	Total
	€m	€m	€m	€m	€m	€m	€m
Past due 1-29 days	20	176	196	11	40	51	1,716
Past due 30-59 days	1	12	13	22	20	42	531
Past due 60-89 days	2	9	11	10	30	40	226
Past due 90 days or more	161	6	167	53	7	60	153
	184	203	387	96	97	193	2,626

Risk management: Credit risk continued
Balance sheet analysis continued
Risk elements in lending, loans and reserves continued
Loans, REIL and impairments by sector and geographical region
The tables below analyse gross loans and advances to customers, and related REIL, provisions, impairment charges and amounts written-off, by sector and geographical region (by location of office).

	2011							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	1,062	-	-	-	-	-	7	-
Finance	5,143	734	554	14.3%	75.4%	10.8%	183	41
Residential mortgages	1,125	101	59	9.0%	58.2%	5.2%	35	1
Personal lending	102	75	69	73.1%	92.2%	67.4%	(10)	125
Property	701	112	105	16.0%	94.2%	15.0%	7	-
Construction	1,049	14	13	1.3%	99.0%	1.3%	8	-
Manufacturing	7,200	395	239	5.5%	60.5%	3.3%	20	41
Service industries and business activities	14,144	612	380	4.3%	62.1%	2.7%	68	187
Agriculture, forestry and fishing	123	2	2	1.7%	81.5%	1.4%	(5)	2
Finance leases and instalment credit	318	-	-	-	61.6%	0.0%	-	-
Interest accruals	138	-	-	-	-	-	-	-
Latent	-	-	106	-	-	-	(11)	-
	31,105	2,045	1,527	6.6%	74.7%	4.9%	302	397
of which:								
- Domestic	6,953	415	242	6.0%	58.2%	3.5%	(20)	(43)
- Foreign	24,152	1,630	1,285	6.7%	78.9%	5.3%	322	440
Total	31,105	2,045	1,527	6.6%	74.7%	4.9%	302	397

	2010							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	1,544	-	-	-	-	-	66	-
Finance	13,083	570	372	4.4%	65.2%	2.8%	157	46
Residential mortgages	984	54	26	5.5%	48.1%	2.6%	22	1
Personal lending	427	331	290	77.5%	87.7%	68.0%	29	266

Property	1,110	112	62	10.1%	55.4%	5.6%	-	-
Construction	919	8	8	0.9%	98.8%	0.9%	4	2
Manufacturing	9,213	398	260	4.3%	65.3%	2.8%	(253)	1,555
Service industries and business activities	18,297	692	391	3.8%	56.6%	2.1%	17	60
Agriculture, forestry and fishing	165	4	2	2.4%	50.0%	1.0%	1	-
Finance leases and instalment credit	54	-	-	-	-	-	-	-
Interest accruals	227	-	-	-	-	-	-	-
Latent	-	-	116				77	-
	46,023	2,169	1,527	4.7%	70.4%	3.3%	120	1,930
of which:								
- Domestic	9,844	574	223	5.8%	38.9%	2.3%	80	1,506
- Foreign	36,179	1,595	1,304	4.4%	81.8%	3.6%	40	424
Total	46,023	2,169	1,527	4.7%	70.4%	3.3%	120	1,930

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Risk management: Credit risk continued
Balance sheet analysis continued
Risk elements in lending, loans and reserves continued
Loans, REIL and impairments by sector and geographical region continued

	2009							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	2,623	3	1	0.1%	33.3%	0.0%	1	16
Finance	36,811	966	513	2.6%	53.1%	1.4%	497	247
Residential mortgages	102,678	473	104	0.5%	22.0%	0.1%	116	73
Personal lending	3,026	678	-	22.4%	0.0%	0.0%	208	139
Property	5,324	229	148	4.3%	64.6%	2.8%	104	47
Construction	1,426	51	36	3.6%	70.6%	2.5%	20	16
Manufacturing	19,890	3,101	2,328	15.6%	75.1%	11.7%	1,044	278
Service industries and business activities	47,503	2,338	1,778	4.9%	76.0%	3.7%	699	441
Agriculture, forestry and fishing	5,202	284	133	5.5%	46.8%	2.6%	94	18
Finance leases and instalment credit	19	-	-	-	-	-	-	-
Interest accruals	1,092	-	-	-	-	-	-	-
Latent	-	-	595	-	-	-	(19)	-
	225,594	8,123	5,636	3.6%	69.4%	2.5%	2,764	1,275
of which:								
- Domestic	159,119	5,490	4,085	3.5%	74.4%	2.6%	1,644	756
- Foreign	66,475	2,633	1,551	4.0%	58.9%	2.3%	1,120	519
Total	225,594	8,123	5,636	3.6%	69.4%	2.5%	2,764	1,275

Impairment loss provision methodology
A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

For retail loans, which are segmented into collective, homogenous portfolios, time-based measures, such as days past due, are typically used as evidence of impairment. For these portfolios, RBSH Group recognises an impairment at 90 days past due.

For corporate portfolios, given their complexity and nature, RBSH Group relies not only on time-based measures but also on management judgement to identify evidence of impairment. Other factors considered may include: significant financial difficulty of the borrower; a breach of contract; a loan restructuring; a probable bankruptcy; and any observable data indicating a measurable decrease in estimated future cash flows.

Depending on various factors as explained below, RBSH Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

- Individually assessed provisions: provisions required for individually significant impaired assets are assessed on a case-by-case basis. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present values of the estimated cash flows discounted at the financial asset's original effective interest rate. Future cash flows are estimated through a case-by-case analysis of individually assessed assets. This assessment takes into account the benefit of any guarantee or other collateral held. The value and timing of cash flow receipts are based on available estimates in conjunction with facts available at that time. Timings and amounts of cash flows are reviewed on subsequent assessment dates, as new information becomes available. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.

- Collectively assessed provisions: provisions on impaired credits below an agreed threshold are assessed on a portfolio basis to reflect the homogeneous nature of the assets. RBSH Group segments impaired credits in its collectively assessed portfolios according to asset type, such as credit cards, personal loans, mortgages and smaller homogenous wholesale portfolios, such as business or commercial banking. A further distinction is made between those impaired assets in collections and those in recoveries (refer to 'Problem debt management' on pages 193 to 196). The provision is determined based on a quantitative review of the relevant portfolio, taking account of the level of arrears, the value of any security, historical and projected cash recovery trends over the recovery period. The provision also incorporates any adjustments that may be deemed appropriate given current economic and credit conditions. Such adjustments may be determined based on: a review of the current cash collections profile performance against historical trends; updates to metric inputs - including model recalibrations; and monitoring of operational processes used in managing exposures - including the time taken to process non-performing exposures.

Risk management: Credit risk continued
Balance sheet analysis continued
Impairment loss provision methodology continued

- Latent loss provisions: a separate approach is taken for provisions held against impairments in the performing portfolio that have been incurred as a result of events occurring before the balance sheet date but which have not been identified at the balance sheet date.

RBSH Group's methodologies to estimate latent loss provisions reflect:

- the probability that the performing customer will default;
- historical loss experience, adjusted, where appropriate, given current economic and credit conditions; and
- the emergence period, defined as the period between an impairment event occurring and a loan being identified and reported as impaired.

Emergence periods are estimated at a portfolio level and reflect the portfolio product characteristics such as the repayment terms and the duration of the loss mitigation and recovery processes. They are based on internal systems and processes within the particular portfolio and are reviewed regularly.

As with collectively assessed impaired portfolios, RBSH Group segments its performing portfolio according to asset type.

Provision and AFS reserves
RBSH Group's consumer portfolios, which consist of high volume, small value credits, have highly efficient largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery methods. Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements.

Provisions are assessed on a case-by-case basis by experienced specialists with input from professional valuers and accountants. RBSH Group operates a transparent provisions governance framework, setting thresholds to trigger enhanced oversight and challenge.

Analysis of provisions is set out on page 69 and below.

Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs and are subsequently measured at fair value with changes in fair value reported in shareholders' equity until disposal, at which stage the cumulative gain or loss is recognised in profit or loss. When there is objective evidence that an available-for-sale financial asset is impaired, any decline in its fair value below original cost is removed from equity and recognised in profit or loss.

RBSH Group reviews its portfolios of available-for-sale financial assets for evidence of impairment which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgment.

Analyses of AFS debt securities and related AFS reserves are set out on page 73.

Movement in loan impairment provisions
The movement in provisions balance is shown in the table below.

	2011	2010	2009
	€m	€m	€m
At 1 January	1,572	5,711	4,564
Transfers to disposal groups	-	(2,377)	756
Currency translation and other adjustments	68	212	151
Disposal of subsidiaries	(45)	-	(73)
Amounts written-off	(397)	(1,943)	(1,275)
Recoveries of amounts previously written-off	22	59	10
Charged to the income statement	360	(78)	1,621
Unwind of discount (recognised in interest income)	(8)	(12)	(43)
At 31 December	1,572	1,572	5,711
Individually assessed:			
- banks	45	45	75
- customers	1,298	1,261	4,365
Collectively assessed	123	150	676
Latent	106	116	595
	1,572	1,572	5,711

Risk management: Credit risk continued
Balance sheet analysis continued
Analysis of loan impairment charge
The following table analyses impairment losses.

	2011 €m	2010 €m	2009 €m
Latent loss	(13)	(120)	(125)
Collectively assessed	25	101	11
Individually assessed	348	(59)	1,735
Charge to income statement continuing operations	360	(78)	1,621
Loans to banks	-	(15)	30
Loans to customers	360	(63)	1,591
(Recoveries)/recharge to RBS plc under APS back-to-back agreement	(58)	138	-
Securities	1,463	7	2
Charge to income statement continuing operations	1,765	67	1,623
Charge to income statement discontinuing operations	9	45	1,172
Charge to income statement	1,774	112	2,795
Charge relating to customer loans as a % of gross customer loans (1)	1.0%	0.2%	0.7%

Notes:
(1) Customer loan impairment charge as a percentage of gross loans and advances to customers including assets of disposal groups and excluding reverse repurchase agreements.

	2011			2010			2009
	Core €m	Non-Core €m	Group €m	Core €m	Non-Core €m	Group €m	Group €m
Loan impairment losses							
- customers (1)	291	11	302	29	46	75	1,591
- banks	-	-	-	6	(21)	(15)	30
	291	11	302	35	25	60	1,621
Impairment losses on securities							
- debt securities	1,463	-	1,463	-	7	7	-
- equity securities	-	-	-	-	-	-	2
Charge to income statement continuing operations	1,754	11	1,765	35	32	67	1,623
Charge to income statement discontinuing operations	-	9	9	-	45	45	1,172

Notes:

(1) Net of recoveries/recharge to RBS plc under APS back-to-back agreement.

Risk anagement: Credit risk continued
Balance sheet analysis continued
Available-for-sale debt securities and reserves
The table below analyses available-for-sale (AFS) debt securities by issuer and related AFS reserves net of tax, relating to securities issued by governments and other entities by country.

	2011					2010				
	Government	ABS	Other	Total	AFS Reserve	Government	ABS	Other	Total	AFS Reserve
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Netherlands	746	6,764	170	7,680	(399)	3,526	7,113	171	10,810	(720)
Spain	39	7,623		7,662	(1,858)	45	7,838	-	7,883	(1,143)
Germany	4,739	791	131	5,661	(13)	6,680	1,331	132	8,143	(25)
United States	2,485	162	41	2,688	63	2,294	164	124	2,582	4
France	1,967	623	9	2,599	(104)	2,729	623	5	3,357	(50)
Italy	842	190	-	1,032	(292)	1,050	196	-	1,246	(99)
Belgium	879	-	-	879	(139)	877	-	-	877	(47)
India	699	-	109	808	(4)	636	-	161	797	2
Austria	329	178	156	663	(71)	314	60	154	528	(23)
Denmark	504	-	-	504	-	730	-	-	730	-
China	471	-	-	471	1	499	-	1	500	(1)
Hong Kong	467	-	-	467	-	759	-	7	766	2
Greece	373	-	-	373	-	1,038	-	-	1,038	(600)
Sweden	34	289	-	323	(2)	34	312	-	346	(2)
Ireland	122	176	-	298	(95)	115	170	-	285	(75)
United Kingdom	-	250	8	258	(27)	-	242	8	250	(21)
Romania	207	-	-	207	-	302	-	-	302	(5)
Malaysia	194	-	-	194	-	193	-	-	193	-
Portugal	68	109	-	177	(116)	107	123	-	230	(41)
Other	911	207	331	1,449	(9)	1,582	217	220	2,019	314
Total	16,076	17,362	955	34,393	(3,065)	23,510	18,389	983	42,822	(2,530)

Key points

- RBS Holdings N.V. holds €34.4 billion of debt securities classified as available-for-sale, the majority of which forms part of the Treasury liquidity buffer. Of the portfolio, €11.2 billion is OECD government issued debt, comprising mainly (€10.9 billion) exposures to European issuers.

- In 2011, RBSH Group recorded an impairment loss of €1.5 billion in respect of Greek government bonds, thereby reducing the carrying value to the market price as at 31 December 2011.

- Further positions in financial instruments comprise €17.4 billion of mortgage and other asset-backed securities. The composition of this portfolio has not changed substantially from 31 December 2010. Included are €6.8 billion residential mortgage-backed securities covered by the Dutch mortgage guarantee scheme and €9.0 billion residential mortgage covered bonds the majority of which originated in Spain.

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Country risk

Country risk is the risk of material losses arising from significant country-specific events such as sovereign events (default or restructuring); economic events (contagion of sovereign default to other parts of the economy, cyclical economic shock); political events (transfer or convertibility restrictions and expropriation or nationalisation); and natural disaster or conflict. Such events have the potential to affect elements of RBSH Group's credit portfolio that are directly or indirectly linked to the country in question and can also give rise to market, liquidity, operational and franchise risk related losses.

External risk environment

2011 was another year of heightened country risks. However, trends were divergent, with conditions deteriorating among vulnerable eurozone countries facing growth impediments and higher public debt burdens, while many emerging markets continued to enjoy relative stability, seeing net inflows of capital for the full year and lower spreads despite some risk aversion in the second half. In the US, notwithstanding a more challenging political environment and a sovereign downgrade from a rating agency, a deal was secured to increase the sovereign debt ceiling, and yields on government debt remain low.

Eurozone risks

Europe was at the centre of rising global risks, owing to a combination of slower growth among some of its major economies and a further deepening of the ongoing sovereign crisis, which in turn harmed financial sector health. Risks in Greece rose as a deeper than expected contraction in GDP impacted the fiscal adjustment programme and hit debt sustainability. Negotiations on a voluntary restructuring of public debt held by the private sector commenced in the first half and a deal was finalised in March 2012, resulting in a contained default event. This in turn led to an agreement by eurozone leaders on a further borrowing programme for the Greek government.

In May 2011, Portugal's new government agreed a borrowing programme with the European Union - International Monetary Fund (EU-IMF) after a sharp deterioration in sovereign liquidity. Ireland's performance under its EU-IMF programme was good and the announcement of a bank restructuring deal without defaults on senior debt obligations helped improve market confidence. This was reflected in a compression in bond spreads in the second half of the year.

Despite the announcement of significant new support proposals by eurozone leaders in July 2011, investor worries over risks to their implementation rose and market conditions worsened markedly as a result. Risk aversion towards Spanish and Italian assets picked up and despite a policy response by both countries, yields remained elevated, prompting the ECB to intervene to support their bonds in secondary markets for the first time. Contagion affected bank stocks and asset prices. Eurozone leaders responded by stepping up anti-crisis efforts, focusing largely on agreeing fiscal reform, bolstering bank capital and strengthening capacity to offer financing support to sovereigns losing market access. The ECB continued to buy sovereign debt in the secondary market and increased liquidity support to banks with the introduction of an emergency three-year long-term refinancing operation in December. This helped ease interbank funding tensions somewhat and may have contributed to some relief in sovereign debt markets late in the year, as yields on new issuance by Spain and Italy dropped.

Emerging markets

Emerging markets continued to perform relatively well. In Asia, despite slowing growth, China and India continued to post strong overall expansion, while generally large external savings levels reinforced balance of payments stability. In China specifically, measures to curb house price growth began to have a more noticeable impact, with real estate prices falling in many cities. Efforts are underway to address some bank asset quality concerns linked to rapid lending growth in 2009.

In Emerging Europe, Russia experienced some contagion into asset markets from weaker commodity prospects and a challenging investment climate, but the sovereign balance sheet remained quite robust. Foreign exchange debts remained a risk factor in a number of Eastern European economies. Elsewhere, Turkey's economy cooled in the second half of 2011, helping to narrow the current account deficit sharply, though external vulnerabilities persisted.

The Middle East and North Africa witnessed political instability in a number of the relatively lower-income countries. The path of any transition has yet to become fully clear in most cases. Excluding Bahrain, pressures for change were more contained in the Gulf Co-Operation Council countries.

Latin America remained characterised by relative stability owing to balance sheet repair by a number of countries following crises in previous decades. Capital inflows contributed to currency appreciation, but overheating pressures have so far proven contained, including in Brazil where credit growth slowed from high levels.

Outlook
Overall, the outlook for 2012 remains challenging with risks likely to remain elevated but divergent. Much will depend on the success of EU efforts to contain contagion from the sovereign crisis (where downside risks are high) and whether growth headwinds in larger advanced economies persist. Emerging market balance sheet risks remain lower, despite ongoing structural and political constraints, but these economies will continue to be affected by events elsewhere through financial markets and trade channels.

Governance
All country exposures in RBSH Group are covered by RBSG Group's country risk framework. In this framework, a limited number of advanced countries are under risk-based monitoring only, with all other countries placed under limit control using RBSG Group's country risk watch list process either when these have been identified as exhibiting signs of stress, or when it is considered appropriate. Detailed portfolio reviews are undertaken to align country risk profiles to RBSG Group's country risk appetite in light of evolving economic and political developments.

Country risk limits are set within the country risk appetite framework of RBSG Group and under consideration of the capital size of the RBSH Group and the country risk grade. Authority is delegated to RBSG Group Country Risk Committee to manage exposures within this framework, with escalation to the RBSH RCC in case of country risk appetite excesses.

Risk management: Country risk continued
RBSG Group appetite is set for individual countries based on a risk assessment taking into account the country’s economic situation and outlook as well as RBSG Group’s franchise and business mix in that country. Additional limitations (for example, on foreign-currency exposure and product types with higher potential for loss in case of country events) may be established to address specific vulnerabilities in the context of a country's outlook and/or RBSG Group's business strategy in a particular country

Monitoring, management and mitigation
A country watchlist framework is in place to proactively monitor emerging issues and facilitate the development of mitigation strategies.

Management of country risk was further strengthened in 2011 with intensified stress testing, portfolio actions on a number of countries and enhancements to risk appetite setting and management systems, contributing inter alia to a reduction in exposures to a range of countries.

During 2011, RBSG Group conducted an analysis of its country risk profile. The outcome of this analysis was used to define more specific scenarios to be used as trigger events in stress testing - on an ongoing basis - at both Group and divisional levels. Such risk scenarios include a major balance sheet deleveraging across Europe, a default of an eurozone sovereign, or one or more stressed member states exiting the eurozone and undergoing currency redenomination, with subsequent contagion effects.

The situation remains very uncertain and the results of stress tests are sensitive to input assumptions. As a result, estimates of the potential impact on RBSH Group of various developments are wide-ranging. If a single country exits the eurozone, the impact could be limited. If several do, the impact is likely to be significant. Depending on the circumstances, the generally negative effect on RBSH Group of devaluations could be offset by the impact of revaluations. Nonetheless, the extent of market disruption is very difficult to predict and could be substantial.

From mid-2011, RBSG Group intensified its risk-mitigating actions at divisional level aimed at preparing RBSG Group for a wide variety of potential eurozone stress scenarios, with a particular focus on counterparty credit risk, settlement risk and funding risk. It also carried out a detailed assessment of the potential impact of such scenarios on Group systems to ensure broad readiness.

In a few specific cases, management of RBSH Group’s exposure was temporarily handed over to a cross-divisional country crisis team. Risk mitigation actions typically included taking guarantees or insurance, updating collateral agreements, credit documentation reviews and specified credit referral processes.

Risk appetite setting was strengthened by various measures. In addition to Greece, Ireland and Portugal, RBSH Group brought Italy and Spain under country limit control. Belgium and Japan followed in January 2012, with other advanced countries scheduled for review in this process throughout 2012. Benchmark ratios systematically guide the setting of medium-term country exposure limits.

RBSH Group’s regular, comprehensive and detailed country exposure reviews were further enhanced by intensified counterparty monitoring.

All of this, in combination with customers' own efforts to reduce their debt levels, contributed to reductions in exposure to a range of countries including the vulnerable eurozone countries, Japan and countries in political transition in North Africa and the Middle East. Exposure reductions were implemented selectively, often retaining some credit lines for strategic clients and in cases of sufficient risk mitigation. Due to their nature, medium-term exposures cannot be adjusted as rapidly as short-term exposure.

Further strategic enhancements to portfolio management systems included the introduction of a comprehensive country risk management and reporting application, comprising banking and trading book exposures across RBSH Group on a consistent basis, and taking account of country risk transfers given guarantees, insurance and collateral taken. This system supports analysing and managing the exposures to countries in the eurozone and elsewhere, by tenor bucket, currency type, sector and product type, as well as by individual counterparty names and facilities. In addition, developments in trading book management systems played a role in actual exposure reductions in trading on a number of countries.

Internal rating systems were also further developed, contributing to more accurate calculations of country-specific default probabilities and expected loss-given-default rates which are determinants in the calculation of risk-weighted assets and economic capital.

Other developments in country risk management in 2011 included the development of the regional and country risk view in RBSH Group's economic capital model and in integrated stress testing.

Going forward, RBSH Group continues to extend country limit control to other countries within and outside the eurozone and will continue to manage medium-term exposure closer to its medium-term benchmark ratios. In addition, work is continuing on the determination of actual appetite per country, on the country risk reporting systems and their integration with credit, treasury and finance systems, on the representation of country risk aspects in rating models, economic capital models and integrated stress testing, and on the combination with actual and expected returns. All of this should help RBSH Group determine and steer its risk profile and further optimise RBSH Group's global portfolio management.

Credit default swap (CDS) contracts are used for a number of purposes such as hedging of the credit trading portfolio, management of counterparty credit exposure and the mitigation of wrong-way risk. The RBSH Group generally uses CDS contracts to manage exposure on a portfolio rather than specific exposures. This may give rise to maturity mismatches between the underlying exposure and the CDS contract as well as between bought and sold CDS contracts on the same reference entity.

The terms of RBSH Group's CDS contracts are covered by standard ISDA documentation, which determines if a contract is triggered due to a credit event. Such events may include bankruptcy or restructuring of the reference entity or a failure of the reference entity to repay its debt or interest. Under the terms of a CDS contract, one of the regional ISDA Credit Derivatives Determinations Committees is empowered to decide whether or not a credit event has occurred.

Risk management: Country risk continued

Country risk analysis

The following tables show RBSH Group's exposure at 31 December 2011 by country of incorporation of the counterparty. Countries shown are those where RBSH Group's balance sheet exposure to counterparties incorporated in the country exceeded £0.5 billion (approximately €0.6 billion) and the country had an external rating of A+ or below from S&P, Moody's or Fitch at 31 December 2011, as well as selected eurozone countries. The numbers exclude balances with RBSG Group and are stated before taking into account the impact of mitigating actions, such as collateral, insurance or guarantees, which may have been taken to reduce or eliminate exposure to country risk events. Exposures relating to ocean-going vessels are not included due to their multinational nature. For further details of exposures relating to available-for-sale debt securities by country, refer to page 73.

The following definitions apply to the tables on pages 77 to 81:

Lending comprises gross loans and advances, to: central and local governments; central banks, including cash balances; other banks and financial institutions, incorporating overdraft and other short-term credit lines; corporations, in large part loans and leases; and individuals, comprising mortgages and personal loans. Includes impaired loans and loans where an impairment event has taken place, but the impairment provision is recognised.

Debt securities comprise securities classified as available-for-sale (AFS), loans and receivables (LAR), held-for-trading (HFT) and designated as at fair value through profit or loss (DFV). All debt securities other than LAR securities are carried at fair value; LAR debt securities are carried at amortised cost less impairment. HFT debt securities are presented as gross long positions (including DFV securities) and short positions per country. Impairment losses and exchange differences relating to AFS debt securities, together with interest are recognised in the income statement; other changes in the fair value of AFS securities are reported within AFS reserves, which are presented gross of tax.

Derivatives comprise the mark-to-market (mtm) value of such contracts after the effect of enforceable netting agreements, but gross of collateral. Reverse repurchase agreements comprise the mtm value of counterparty exposure arising from repo transactions net of collateral.

Balance sheet exposures comprise lending exposures, debt securities and derivatives and repo exposures.

Contingent liabilities and commitments comprise contingent liabilities, including guarantees, and committed undrawn facilities.

Credit default swaps (CDSs) under a CDS contract, the credit risk on the reference entity is transferred from the buyer to the seller. The fair value, or mtm, represents the balance sheet carrying value. The mtm value of CDSs is included within derivatives against the counterparty of the trade, as opposed to the reference entity. The notional is the par amount of the credit protection bought or sold and is included against the reference entity of the CDS contract.

The column CDS notional less fair value represents the notional less fair value amounts arising from sold positions netted against those arising from bought positions, and represents the net change in exposure for a given reference entity should the CDS contract be triggered by a credit event, assuming there is a zero recovery rate. However, in most cases, RBSH Group expects the recovery rate to be greater than zero and the exposure change to be less than this amount.

RBSH Group primarily transacts CDS contracts with investment-grade global financial institutions who are active participants in the CDS market. These transactions are subject to regular margining. For European peripheral sovereigns, credit protection has been purchased from a number of major European banks, predominantly outside the country of the reference entity. In a few cases where protection was bought from banks in the country of the reference entity, giving rise to wrong-way risk, this risk is mitigated through specific collateralisation.

'Other eurozone' refers to Austria, Cyprus, Estonia, Finland, Malta, Slovakia and Slovenia. The Netherlands, while being a eurozone country, has been excluded in these country risk tables as RBS N.V. is based in the Netherlands.

Business review continued

Business Review
Risk and balance sheet management

Risk management: Country risk continued

	Lending												
2011	Central and local government €m	Central banks €m	Other banks €m	Other financial institutions €m	Corporate €m	Personal €m	Total lending €m	Debt securities €m	Derivates (gross of collateral) and repos €m	Balance sheet exposures €m	Contingent liabilities and commitments €m	Total €m	CDS (notional less fair value) €m
Eurozone													
Spain	-	4	4	1	813	-	822	7,662	5	8,489	1,576	10,065	(39)
Italy	-	2	20	99	1,329	-	1,450	1,104	699	3,253	928	4,181	(115)
Greece	8	7	-	-	457	-	472	373	1	846	24	870	-
Ireland	-	8	16	-	151	-	175	367	57	599	429	1,028	192
Portugal	-	-	8	-	32	-	40	176	74	290	67	357	(4)
Germany	-	42	12	17	748	85	904	5,675	599	7,178	3,188	10,366	(140)
France	-	-	91	35	923	-	1,049	2,599	301	3,949	2,110	6,059	(252)
Luxembourg	-	-	-	75	314	-	389	(47)	1,537	1,879	324	2,203	(87)
Belgium	-	10	11	391	337	-	749	879	196	1,824	766	2,590	(12)
Other eurozone	-	-	17	22	275	-	314	722	30	1,066	403	1,469	(12)
Total eurozone	8	73	179	640	5,379	85	6,364	19,510	3,499	29,373	9,815	39,188	(469)
Other countries													
India	-	329	533	42	3,076	132	4,112	1,732	231	6,075	867	6,942	-
China	11	213	1,470	19	763	5	2,481	654	100	3,235	1,626	4,861	(12)
Republic of Korea	-	6	764	2	685	-	1,457	711	286	2,454	595	3,049	-
Turkey	257	231	300	75	1,176	-	2,039	69	77	2,185	406	2,591	-
Romania	79	173	36	10	494	469	1,261	240	7	1,508	190	1,698	-
Russia	-	43	404	10	461	-	918	209	27	1,154	305	1,459	-
Poland	42	249	-	11	684	-	986	127	11	1,124	825	1,949	-
Brazil	-	-	-	-	222	-	222	826	6	1,054	13	1,067	-
Mexico	-	8	24	-	709	-	741	44	73	858	334	1,192	-
Indonesia	87	53	165	8	153	-	466	150	207	823	81	904	-
Czech Republic	-	-	-	-	357	-	357	247	47	651	164	815	-
Malaysia	-	4	20	43	147	7	221	269	159	649	149	798	-

Risk management: Country risk continued

2010	Lending: Central and local government €m	Lending: Central banks €m	Lending: Other banks €m	Lending: Other financial institutions €m	Lending: Corporate €m	Lending: Personal €m	Lending: Total lending €m	Debt securities €m	Derivates (gross of collateral) and repos €m	Balance sheet exposures €m	Contingent liabilities and commitments €m	Total €m	CDS (notional less fair value) €m
Eurozone													
Spain	-	6	2	1	830	-	839	7,896	39	8,774	1,945	10,719	(562)
Italy	43	2	27	180	622	-	874	1,359	670	2,903	2,021	4,924	(382)
Greece	16	27	20	-	136	-	199	1,038	3	1,240	140	1,380	-
Ireland	-	6	15	89	184	-	294	352	368	1,014	1,222	2,236	10
Portugal	-	-	19	-	32	-	51	231	56	338	379	717	(16)
Germany	-	55	16	35	892	90	1,088	8,269	1,315	10,672	4,135	14,807	(1,341)
France	-	-	15	22	914	-	951	3,409	1,562	5,922	3,411	9,333	(1,211)
Luxembourg	-	29	5	162	524	-	720	106	1,391	2,217	724	2,941	(186)
Belgium	-	16	269	32	442	355	1,114	884	82	2,080	982	3,062	(19)
Other eurozone	-	1	21	45	247	-	314	590	87	991	1,098	2,089	(30)
Total eurozone	59	142	409	566	4,823	445	6,444	24,134	5,573	36,151	16,057	52,208	(3,737)
Other countries													
India	-	-	1,515	356	2,844	298	5,013	1,951	190	7,154	1,326	8,480	(128)
China	20	321	1,402	14	735	39	2,531	666	49	3,246	1,534	4,780	(20)
Republic of Korea	-	320	952	6	620	-	1,898	1,106	444	3,448	1,140	4,588	(94)
Turkey	327	79	503	43	1,438	-	2,390	105	87	2,582	625	3,207	-
Romania	42	206	24	19	482	516	1,289	355	9	1,653	366	2,019	-
Russia	-	128	282	8	1,248	3	1,669	126	23	1,818	609	2,427	(15)
Poland	-	195	-	7	658	-	860	235	16	1,111	1,156	2,267	-
Brazil	-	-	1	-	300	-	301	710	12	1,023	97	1,120	(16)
Mexico	-	9	37	-	1,043	-	1,089	150	86	1,325	890	2,215	(45)
Indonesia	97	49	281	8	262	1	698	406	205	1,309	240	1,549	(7)
Czech Republic	-	3	-	-	423	-	426	320	193	939	219	1,158	-
Malaysia	-	51	48	57	172	12	340	299	152	791	79	870	(19)

Risk management: Country risk continued

Key points

- Reported exposures are affected by currency movements. During 2011, the euro fell 3.3% against the US dollar and 3.1% against the British pound.

- Exposure to most countries shown in the table declined over 2011 as RBSH Group maintained a cautious stance and many bank clients reduced debt levels. Decreases were seen in balance sheet and off-balance sheet exposures in many countries. Increases in derivatives and repos in a few countries were in line with RBSH Group's strategy, driven partly by customer demand for hedging solutions and partly by market movements; risks are generally mitigated by active collateralisation.

- India - despite strong economic growth in 2011, exposure was reduced across most product types, particularly in the fourth quarter, driven by a GTS exercise in the region to manage down risk-weighted assets, natural run-offs/maturities and a sharp rupee depreciation. Year-on-year increases in lending to corporate clients (€0.2 billion) and the central bank (€0.3 billion) were offset by reductions in lending to banks (€1.0 billion) and other financial institutions (€0.3 billion).

- China - lending to Chinese banks increased in the first three quarters of the year, supporting trade finance activities and on-shore regulatory needs, but by the end of 2011 exposure had decreased to close to December 2010 levels. RBSH Group reduced lending in the interbank money markets over the final quarter.

- Republic of Korea - exposure decreased by €1.5 billion during 2011. This was due to reductions in lending and off-balance sheet exposures as well as in debt securities as RBSH Group managed its wrong-way risk exposure. RBSH Group maintained a cautious stance given the current global economic downturn.

- Turkey - exposures were managed down in most categories, with the non-strategic (mid-market) portfolio significantly reduced in 2011. Nonetheless, Turkey continues to be one of RBSH Group's key emerging markets. The strategy remains client-centric, with the product offering tailored to selected client segments across large Turkish international corporate clients and financial institutions as well as Turkish subsidiaries of global clients.

- Mexico - asset sales and a number of early repayments in the corporate portfolio led to exposure falling €1.0 billion in the year. This decline also reflects RBSH Group's cautious approach to new business during the fourth quarter following its decision to close its onshore operation in Mexico.

- Eurozone periphery (Spain, Italy, Greece, Ireland and Portugal) - Exposure decreased across most of the periphery, with derivatives (gross of collateral) and repos being the only component that still saw some increases year on year (partly an effect of market movements on existing positions). Much of RBSH Group's country risk exposure to the eurozone periphery countries arises from the activities of GBM. RBSH Group has some large holdings of Spanish bank and financial institutions MBS bonds and smaller quantities of Italian bonds and Greek sovereign debt. GTS provides trade finance facilities to clients across Europe including the eurozone periphery. Please see detailed commentary on RBSH Group's exposure to eurozone countries on page 81.

- RBSH Group primarily transacts CDS contracts with investment-grade global financial institutions that are active participants in the CDS market. These transactions are subject to regular margining. For European peripheral sovereigns, credit protection has been purchased from a number of major European banks, predominantly outside the country of the reference entity. In a few cases where protection was bought from banks in the country of the reference entity, giving rise to wrong-way risk, this risk is mitigated through specific collateralisation.

- RBSH Group used CDS contracts throughout 2011 to manage both eurozone country and counterparty exposures. Gross notional bought and sold eurozone CDS contracts fell across the board during 2011, caused by migrations or novations to RBS plc. The magnitude of the fair value of bought and sold CDS contracts decreased for the same reason, and despite a widening of eurozone CDS spreads.

Risk management: Country risk continued

Eurozone

						HFT debt securities			Derivatives (gross of collateral)		CDS by reference entity			
											Notional		Fair value	
	Lending	REIL	Provisions	AFS and LAR debt securities	AFS reserves	Long	Short	Total debt securities	and repos	Balance sheet exposures	Bought	Sold	Bought	Sold
31 December 2011	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Central and local government	8	-	-	9,416	(680)	-	-	9,416	-	9,424	145	20	81	(10)
Central banks	73	-	-	-	-	-	-	-	346	419	-	-	-	-
Other banks	179	-	-	7,223	(1,181)	17	4	7,236	690	8,105	111	17	23	(1)
Other financial institutions	640	-	-	2,609	(826)	6	55	2,560	2,242	5,442	305	12	404	(1)
Corporate	5,379	618	528	298	(5)	-	-	298	221	5,898	544	18	74	(1)
Personal	85	74	55	-	-	-	-	-	-	85	-	-	-	-
	6,364	692	583	19,546	(2,692)	23	59	19,510	3,499	29,373	1,105	67	582	(13)
31 December 2010														
Central and local government	59	-	-	13,013	(1,170)	61	-	13,074	1	13,134	-	-	-	-
Central banks	142	-	-	-	-	-	-	-	226	368	-	-	-	-
Other banks	409	-	-	7,509	(1,058)	84	-	7,593	2,857	10,859	334	7	110	(6)
Other financial institutions	566	-	-	2,991	(594)	-	-	2,991	2,090	5,647	874	16	511	(10)
Corporate	4,823	377	255	286	(2)	190	-	476	399	5,698				