

ROYAL BANK OF SCOTLAND GROUP PLC
Form 6-K
February 26, 2009

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

Report of Foreign Private Issuer

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

For the month of February 2009

Commission File Number: 001-10306

The Royal Bank of Scotland Group plc

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

Form 20-F

Form 40-F

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

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Yes

No

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

The following information was issued as Company announcements, in London, England and is furnished pursuant to General Instruction B to the General Instructions to Form 6-K:

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Note: the following acronyms are used in this supplement

ABCP Asset-backed commercial paper

ABS	Asset-backed securities
CDO	Collateralised debt obligations
CDS	Credit default swap
CLO	Collateralised loan obligations
CP	Commercial paper
CMBS	Commercial mortgage-backed securities
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
Ginnie Mae	Government National Mortgage Association
GSE	Government Sponsored Entity
IASB	International Accounting Standards Board
RMBS	Residential mortgage-backed securities
SIV	Structured investment vehicle
SPE	Special purpose entity
US agencies	Ginnie Mae, Fannie Mae, Freddie Mac and similar entities

Credit market and related exposures

1. Explanatory note

These disclosures provide information for certain of the Group's business activities affected by the unprecedented market events of 2008, the majority of which arose within Global Banking and Markets (GBM), and supplement Credit market exposures table on page 47. The disclosures are focused around GBM's credit markets activities, including the conduit business, which have been particularly affected by the widespread market disruptions, as well as similar exposures in US Retail & Commercial and Group Treasury and, financial instruments where the valuation includes a higher level of subjectivity or complexity.

In preparing these disclosures, the Group took into consideration the leading practice disclosure recommendations of the Financial Stability Forum issued in April 2008 and the report of the IASB Expert Advisory Panel 'Measuring and disclosing fair value of financial instruments in markets that are no longer active' issued in October 2008. All the disclosures in this appendix are audited except for section 2, 3.6, 8.3 and 8.4.

2. Market background

Overall, 2008 has been characterised by rapid dislocation in financial markets. In many cases, the dramatic liquidity squeeze and rise in funding costs for financial institutions has resulted in reluctance or inability of market participants to transact, and has adversely affected the performance of most financial institutions globally, including the Group. Stock markets have experienced extraordinary falls, and levels of volatility have been at record highs. Commodity prices have reduced sharply in the second half of the year, and credit spreads continued to widen. Market perception of counterparty risk increased and the failure of major credit protection providers caused fair value losses for the Group and other market participants and further increased the costs of mitigating credit exposure. Sustained falls globally in both residential and commercial real estate prices, fund valuations and worsening loan performance combined with a sustained lack of liquidity in the market, resulted in a greater amount of assets being valued at significantly lower prices.

An indication of the continued decline in the price of asset backed securities (ABS), in particular those collateralised with sub-prime assets, is shown in graph 1 of the attached PDF. While not fully representative of the Group's ABS exposures or pricing basis, the ABX series of indices charted in the graph show, in bond price terms, how differently rated ABS referencing US sub-prime mortgages securitised in 2007 have performed during the year.

http://www.rns-pdf.londonstockexchange.com/rns/9131N_-2009-2-26.pdf

Graph 2 of the attached PDF provides an indication of the change in credit worthiness of corporate entities to which the Group has significant exposure through its credit products in the form of credit derivatives and bonds. The MarkiT iTraxx Europe graph demonstrates the impact of the movement of credit spreads in price terms for a basket of European corporate entities (prices rebased to 100 at the beginning of the year).

The first quarter of 2008 saw a continuation of credit and liquidity shortages experienced during 2007, culminating in the collapse of Bear Stearns in March. The centre of the credit issues remained the ABS market with worsening US economic data supporting higher levels of default expectation in the property market. However, these default expectations started to go beyond the sub-prime market with Alt A and other non-conforming classes of loans particularly seeing significant price deterioration. In addition, wider economic concerns led to heavy fair value losses in the commercial mortgage backed securities market, in corporate debt and in leveraged loan exposures. Following this tightening of conditions, the Group incurred significant losses in March [and took steps in April to materially strengthen its capital base through a £12 billion rights issue which was completed in June].

During the second quarter ABS prices initially rallied and steadied, however towards the end of the quarter a negative house price trend in the UK became clear, and in the US, market reaction to sub-prime mortgages extended to prime and near prime lending. Corporate credit spreads followed a similar pattern reacting to rising oil prices, inflationary pressures and continuing high LIBOR despite base rate cuts to 5% in April.

Credit spreads continued to widen across the market through the third quarter and liquidity levels reduced further, resulting in pressure on banks and economies worldwide. This culminated in the demise of Lehman Brothers in September and further market consolidation and global state intervention to provide support to the banking sector.

During the fourth quarter there was a continued lack of confidence in the inter-bank market, with demand for stable investments resulting in US treasuries reaching negative spreads. Corporate and ABS prices fell further particularly in the last two months of the year increasing pressure on banks' capital positions. The Group moved to strengthen its capital position through an open offer to raise £15 billion, underwritten by the UK government. The year concluded with S&P downgrading the credit ratings of eleven global banks, including the Group.

3. Asset-backed exposures

3.1 Significant risk concentrations and losses

The Group's credit markets activities gives rise to risk concentrations that have been particularly affected by the market turmoil experienced since the second half of 2007. The Group structures, originates, distributes and trades debt in the form of loan, bond and derivative instruments in all major currencies and debt capital markets in North America, Western Europe, Asia and major emerging markets.

During 2008, certain assets identified as being high risk were also transferred to a centrally managed asset unit, set up to provide specific management of this portfolio of higher risk assets. Transferred assets are predominantly ABS and associated protection purchased from monoline insurers and other counterparties.

The tables below summarise the net exposures and balance sheet carrying values of these securities by measurement classification and references to sections with further information on specific products.

Held-for-trading	Available-for-sale	Loans and receivables	Designated at fair value	All ABS
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	Section	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<i>Net exposure</i>											
RMBS	3.2	24,462	35,105	44,450	27,875	2,578	5	182	90	71,672	63,075
CMBS	3.3	1,178	2,749	918	977	1,437	626	13	47	3,546	4,399
CDOs& CLOs	3.4	2,463	7,288	2,538	2,174	1,282	-	-	23	6,283	9,485
Other ABS	3.5	195	3,479	6,572	5,579	3,621	72	40	186	10,428	9,316
Total		28,298	48,621	54,478	36,605	8,918	703	235	346	91,929	86,275
<i>Carrying value</i>											
RMBS	3.2	27,849	37,280	44,791	27,880	2,618	5	182	90	75,440	65,255
CMBS	3.3	2,751	3,916	1,126	976	1,437	626	13	37	5,327	5,555
CDOs & CLOs	3.4	7,774	15,477	9,579	2,173	1,284	-	-	26	18,637	17,676
Other ABS	3.5	1,505	5,758	6,572	5,579						