ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
April 29, 2009

As filed with the Securities and Exchange Commission on April 29, 2009

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, 2008
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

Date of event requiring this shell company report ___________
For the transition period from ___________ to ___________

Commission file number 001-10306

THE ROYAL BANK OF SCOTLAND GROUP plc
(Exact name of Registrant as specified in its charter)

United Kingdom
(Jurisdiction of incorporation or organization)

RBS Gogarburn, PO Box 1000, Edinburgh EH12 1HQ
(Address of principal executive offices)

Miller McLean, Group General Counsel and Group Secretary, Tel: +44 (0) 131 523 2333, Fax: +44 (0) 131 626 3081,

PO Box 1000, Gogarburn, Edinburgh EH12 1HQ
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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
American Depositary Shares, each representing 20 ordinary shares, nominal value £0.25 per share	New York Stock Exchange
Ordinary shares, nominal value £0.25 per share	New York Stock Exchange*
American Depositary Shares Series F, H, L, M, N, P, Q, R, S, T and U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, M, N, P, Q, R, S, T and U respectively	New York Stock Exchange
Dollar Perpetual Regulatory tier one securities, Series 1	New York Stock Exchange

* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares pursuant to the requirements of the Securities and Exchange Commission.

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 of the issuer's classes of capital or common stock as of December 31, 2008, the close of the period covered by the annual report:

Ordinary shares of 25 pence each	39,456,004,899	Non-cumulative dollar preference shares, Series F, H and L to U	308,015,000
Non-voting Deferred Shares	2,660,556,304	Non-cumulative convertible dollar preference shares, Series 1	1,000,000
11% cumulative preference shares	500,000	Non-cumulative euro preference shares, Series 1 to 3	2,526,000
5½% cumulative preference shares	400,000	Non-cumulative convertible sterling preference shares, Series 1	200,000
		Non-cumulative sterling preference shares, Series 1 and 2	5,750,000

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

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.
Yes o No x

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.

Yes x No o

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).
Yes o No o

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 x	Accelerated filer o	Non-accelerated filer o

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

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

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.
Item 17 o Item 18 o

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).

Yes o No x

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)
Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Yes o No o

SEC Form 20-F cross reference guide

Business Review

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Presentation of information

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

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

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

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

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

International Financial Reporting Standards

As required by the Companies Act 1985 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together ‘IFRS’) as adopted by the European Union. It also complies with IFRS as issued by the IASB. On implementation of IFRS on 1 January 2005, the Group took advantage of the option in IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ to implement IAS 39 ‘Financial Instruments: Recognition and Measurement’, IAS 32 ‘Financial Instruments: Disclosure and Presentation’ and IFRS 4 ‘Insurance Contracts’ from 1 January 2005 without restating its 2004 income statement and balance sheet. The date of transition to IFRS for the Group and the company and the date of their opening IFRS balance sheets was 1 January 2004.

Acquisition of ABN AMRO

On 17 October 2007, RFS Holdings B.V. (‘RFS Holdings’), a company jointly owned by RBS, Fortis Bank Nederland (Holding) N.V. (‘Fortis’) and Banco Santander S.A. (‘Santander’) (together the ‘consortium members’) and controlled by RBS, completed the acquisition of ABN AMRO Holding N.V. (‘ABN AMRO’).

On 3 October 2008, the State of the Netherlands acquired Fortis Bank Nederland (Holding) N.V. including the Fortis participation in RFS Holdings that represents the acquired activities of ABN AMRO and their participation in Dutch insurance activities.

RFS Holdings is implementing an orderly separation of the business units of ABN AMRO with RBS retaining the following ABN AMRO business units:

- Continuing businesses of Business Unit North America;
- Business Unit Global Clients and wholesale clients in the Netherlands (including former Dutch wholesale clients) and Latin America (excluding Brazil);
- Business Unit Asia (excluding Saudi Hollandi); and
- Business Unit Europe (excluding Antonveneta).

Certain other assets will continue to be shared by the consortium members.

Statutory results
RFS Holdings is jointly owned by the consortium members. It is controlled by the company and is therefore fully consolidated in its financial statements. Consequently, the statutory results of the Group for the year ended 31 December 2007 and 2008 include the results of ABN AMRO for 76 days and the full year respectively. The interests of Fortis, and its successor the State of the Netherlands, and Santander, in RFS Holdings are included in minority interests.

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Forward-looking statements

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

In particular, this document includes forward-looking statements relating, but not limited, to the 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. Such statements are subject to risks and uncertainties. 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: general economic conditions in the UK and in other countries in which the Group has significant business activities or investments, including the United States; the monetary and interest rate policies of the Bank of England, the Board of Governors of the Federal Reserve System and other G7 central banks; inflation; deflation; unanticipated turbulence in interest rates, foreign currency exchange rates, commodity prices and equity prices; changes in UK and foreign laws, regulations and taxes; changes in competition and pricing environments; natural and other disasters; the inability to hedge certain risks economically; the adequacy of loss reserves; acquisitions or restructurings; technological changes; changes in consumer spending and saving habits; and the success of the Group in managing the risks involved in the foregoing.

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

For a further discussion of certain risks faced by the Group, see Risk factors on pages 13 to 20.

Business review

Description of business

Introduction

The Royal Bank of Scotland Group plc is the holding company of a large global banking and financial services group. Headquartered in Edinburgh, the Group operates in the United Kingdom, the United States and internationally through its two principal subsidiaries, the Royal Bank and NatWest. Both the Royal Bank and NatWest are major UK clearing banks whose origins go back over 275 years. In the United States, the Group's subsidiary Citizens is a large commercial banking organisation. The Group has a large and diversified customer base and provides a wide range of products and services to personal, commercial and large corporate and institutional customers.

Following a placing and open offer in December 2008, referred to herein as the First Placing and Open Offer, Her Majesty's Treasury in the United Kingdom (HM Treasury) owned approximately 58% of the enlarged ordinary share capital of the company and £5 billion of non-cumulative sterling preference shares. In April 2009, the company issued new ordinary shares by way of a second placing and open offer, referred to herein as the Second Placing and Open Offer, the proceeds from which were used in full to fund the redemption of the preference shares held by HM Treasury at 101% of their issue price together with the accrued dividend and the commissions payable to HM Treasury under the Second Placing and Open Offer Agreement. The Second Placing and Open Offer was underwritten by HM Treasury and as a result, HM Treasury currently owns approximately 70% of the enlarged ordinary share capital of the company.

The Group had total assets of £2,401.7 billion and owners' equity of £58.9 billion at 31 December 2008. The Group's capital ratios, which include the equity minority interest of The State of the Netherlands and Santander in ABN AMRO, were a total capital ratio of 14.1 per cent., a core Tier 1 capital ratio of 6.8 per cent. and a Tier 1 capital ratio of 10.0 per cent., as at 31 December 2008.

Organisational structure and business overview

The Group's activities are organised in the following business divisions: Global Markets (comprising Global Banking & Markets and Global Transaction Services), Regional Markets (comprising UK Retail & Commercial Banking, US Retail & Commercial Banking, Europe & Middle East Retail & Commercial Banking and Asia Retail & Commercial Banking), RBS Insurance and Group Manufacturing. A description of each of the divisions is given below.

Global Banking & Markets (GBM) is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt and equity financing, risk management and investment services to its customers. In 2008 the division was organised along four principal business lines: rates, currencies, and commodities, including RBS Sempra Commodities LLP (the commodities-marketing joint venture between RBS and Sempra Energy which was formed on 1 April 2008); equities; credit markets; and asset and portfolio management.

Following RBS's strategic review, GBM is planning to re-focus its business around its core corporate and institutional clients, concentrating its activities in major financial centres and scaling back its presence elsewhere. It will exit illiquid proprietary trading and balance sheet-heavy niche products segments.

Globally, the intention is for GBM to move increasingly towards a "hub-and- spoke" model. Risk will be managed from regional hubs. It is intended that distribution and coverage will be delivered from a mix of hub countries and a scaled-back presence in some local offices. The aim, over time, will be to reduce much of the on-shore trading activity outside the key financial centres.

Assets, products and geographies that fit GBM's new client-focused proposition will be defined as "core" and will remain within the division. Assets, business lines and some geographies that are non-core will be transferred to the new Non-Core Bank. These non-core activities accounted for approximately £205 billion of third party assets at end 2008.

Global Transaction Services ranks among the top five global transaction services providers, offering global payments, cash and liquidity management, as well as trade finance, United Kingdom and international merchant acquiring and commercial card products and services. It includes the Group's corporate money transmission activities in the United Kingdom and the United States.

Following RBS's strategic review, Global Transaction Services intends to reduce its international network while retaining the capability to serve multinational clients globally.

The business also plans to increase efficiency through development of a lower cost front and back-office operating model and explore joint ventures for growth and selective disposals.

UK Retail & Commercial Banking (RBS UK) comprises retail, corporate and commercial banking and wealth management services. It supplies financial services through both the RBS and NatWest brands.

UK Retail Banking offers a full range of banking products and related financial services to the personal market. It serves customers through two of the largest networks of branches and ATMs in the United Kingdom, and also through telephone and internet channels and, according to Gfk NOP, is the second largest provider of personal current accounts. The division also issues credit and charge cards, including through other brands such as MINT.

UK Business & Commercial Banking is the largest provider of banking, finance, and risk management services to the SME sector in the United Kingdom. It offers a full range of banking products and related financial services through a nationwide network of relationship managers, and also through telephone and internet channels. The product range includes asset finance, in which, according to the Finance Lease Association, it has a strong market presence through the Lombard brand.

According to Ph. Group, UK Corporate Banking holds the largest market share in the United Kingdom of relationships with larger companies, offering a full range of banking, finance, and risk management services.

UK Wealth Management provides private banking and investment services through Coutts, Adam & Co., RBS International and NatWest Offshore.

US Retail & Commercial Banking provides financial services primarily through the Citizens and Charter One brands.

Citizens is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states. Citizens is a large commercial banking organization.

Following RBS's strategic review, Citizens intends to invest in its core business through increased marketing activity and targeted technology investments while reducing activity in its out-of-footprint national businesses in consumer and commercial finance.

This strategy will allow Citizens to become fully funded from its own customer deposits over time, and will support a low risk profile.

Europe & Middle East Retail & Commercial Banking comprises Ulster Bank and the Group's combined retail and commercial businesses in Europe and the Middle East.

Ulster Bank provides a comprehensive range of financial services across the island of Ireland. Its retail banking arm has a network of branches and operates in the personal, commercial and wealth management sectors, while its corporate markets operations provides services in the corporate and institutional markets.

The retail and commercial businesses in Europe and the Middle East have smaller activities in Romania, Kazakhstan and the United Arab Emirates. Following RBS's strategic review, RBS has decided to exit sub-scale retail and commercial activities outside its core markets in the United Kingdom, Europe and the United States.

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Asia Retail & Commercial Banking is present in markets including India, Pakistan, China, Taiwan, Hong Kong, Indonesia, Malaysia and Singapore. It provides financial services across four segments: affluent banking, cards and consumer finance, business banking and international wealth management, which offers private banking and investment services to clients in selected markets through the RBS Coutts brand.

Following RBS's strategic review, RBS has decided to exit sub-scale retail and commercial activities outside its core markets in the United Kingdom, Europe and the United States.

RBS Insurance sells and underwrites retail and SME insurance over the telephone and internet, as well as through brokers and partnerships. Its brands include Direct Line, Churchill and Privilege, which sell general insurance products direct to the customer, as well as Green Flag and NIG. Through its international division, RBS Insurance sells general insurance, mainly motor, in Spain, Germany and Italy. The Intermediary and Broker division sells general insurance products through independent brokers.

Following RBS's strategic review, RBS has decided to retain RBS Insurance.

Group Manufacturing comprises the Group's worldwide manufacturing operations. It supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Group Manufacturing drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and has become the centre of excellence for managing large-scale and complex change.

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

RFS Holdings minority interest comprises those activities of ABN AMRO that are attributable to the other consortium members.

Share of shared assets comprises the Group's share of the unallocated assets of ABN AMRO.

Non-core division

RBS intends to create during the second quarter of 2009 a non-core division to manage separately approximately £240 billion of third party assets, £145 billion of derivative balances and £155 billion of risk weighted assets that it intends to run off or dispose of over the next three to five years. The division will contain primarily assets from the GBM division linked to proprietary trading portfolios, excess risk concentrations and other illiquid portfolios. It will also include excess risk concentrations from other divisions as well as a number of small Regional Markets businesses that RBS has concluded are no longer strategic.

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Recent developments

HM Treasury Asset Protection Scheme and additional capital raising

On 26 February 2009, RBS confirmed its intended participation in the Asset Protection Scheme ("APS"). The arrangements between RBS and HM Treasury will, if completed, allow RBS to secure asset protection in respect of some of its riskiest assets that enhances its financial strength and provides improved stability for customers and depositors, and also enhances RBS's ability to lend into the UK market.

Issuance of capital

On or after the proposed implementation of the APS, HM Treasury will subscribe for £13 billion of B Shares. The arrangements for the subscription of these B Shares are to be determined and the proceeds of such issue will, if such B Shares are issued, be used to increase further the Group's Core Tier 1 capital. A summary of the expected terms of the B Shares is set out below. HM Treasury will also commit to subscribe for an additional £6 billion of B Shares at RBS's option. The detailed terms of such option remain to be agreed between RBS and HM Treasury.

Scheme amount

RBS intends to participate in the APS in respect of assets with a par value of approximately £325 billion and a carrying value net of impairments and write downs of approximately £302 billion as at 1 January 2009.

First loss

The agreement would see RBS bear the first loss amount relating to the assets in the APS up to £19.5 billion (after taking into account historic impairments and write downs). Losses arising in respect of the assets after the first loss amount would be borne 90 per cent. by HM Treasury and 10 per cent. by RBS. The APS will, if entered into, apply to losses incurred on the protected assets on or after 1 January 2009.

Fee and issuance of capital

If it enters into the APS, RBS will pay a participation fee of £6.5 billion to HM Treasury. On 26 February 2009, RBS announced that it would issue £6.5 billion of B Shares, and the participation fee may be funded through the proceeds of such issuance. The £6.5 billion of B Shares, which will be issued if RBS enters into the APS, will be in addition to, and on the same terms as, the B Shares referred to above and will constitute Core Tier 1 capital. In addition, RBS has agreed in principle that, if it enters into the APS, it would not claim certain UK tax losses and allowances.

Assets

Specific assets to be included in the APS will be subject to the approval of HM Treasury. The assets would be drawn from RBS's and certain of its affiliates' portfolios of corporate and leveraged loans, commercial and residential property loans, structured credit assets and such other assets as HM Treasury and RBS agree are to be included in the APS. It is also envisaged that the APS may include structured synthetic assets and counterparty risk exposures associated with certain derivatives transactions with monoline insurers and credit derivative product companies. RBS expects that the APS will protect: £225 billion of third party assets, £44 billion of undrawn commitments, and £33 billion in other counterparty risk exposures.

Capital ratios

The APS and proceeds of the issue of B Shares are expected to improve the consolidated capital ratios of RBS by (i) substituting risk weight applicable to the UK Government for that of the protected assets; and (ii) the subscription for the B Shares by HM Treasury (being both the £6.5 billion of B Shares, the proceeds of which may be used to fund the fee for the APS and the additional £13 billion of B Shares to be issued on or after the implementation of the APS). Based on total covered assets of approximately £325 billion, risk weighted assets would reduce by approximately £144 billion. As an illustration, if the Company had issued £19.5 billion of B Shares on 31 December 2008 offset by the expected £6 billion reduction of first loss exposure under the APS from Core Tier 1 capital in accordance with the FSA Handbook, and with the redemption of the preference shares issued to HM Treasury ("Preference Share Redemption"), RBS expects there would have been a significant increase to the Core Tier 1 ratio.

In addition, RBS will continue to look at various market based and/or internal capital management opportunities to generate and further strengthen Core Tier 1 capital.

Term

While it is intended that the APS would apply to the protected assets until their maturity, RBS's participation in the APS would be capable of termination in whole or in part by mutual agreement of RBS and HM Treasury.

Management of the assets

RBS would be required under the APS to manage the assets in accordance with certain asset management requirements as referred to in the APS. These would include, amongst others, (i) reporting requirements to provide financial, risk and performance data in respect of the protected assets and to monitor compliance with the APS, (ii) the adoption of oversight and control procedures with respect to the management of the protected assets, (iii) requirements in relation to organisational structure, staffing, resourcing, systems and controls required for implementation, administration and monitoring compliance with the APS and (iv) the monitoring and management of conflicts of interest and potential conflicts of interest. As the APS is intended to apply to losses on protected assets arising from 1 January 2009, RBS has agreed with HM Treasury certain interim arrangements (in force with immediate effect) relating to the management of those assets likely to be part of the APS.

Impact on the capital structure of the Company

If the additional £6 billion of B Shares are subscribed for by HM Treasury and £25.5 billion of B Shares convert mandatorily, or are converted by HM Treasury, into ordinary shares in the hands of HM Treasury, the percentage of HM Treasury's ownership of RBS's ordinary shares will be 84.4 per cent., with shareholders experiencing a corresponding dilution to their interests in the company. However, without prejudice to rights arising on the mandatory conversion into ordinary shares, HM Treasury shall not be entitled to exercise its option to convert B Shares into ordinary shares for as long as it holds 75 per cent. or more of the ordinary shares or if the exercise of such option would result in it holding 75 per cent. or more of the ordinary shares. Further details regarding the effect of the B Shares on the dividends payable are set out below.

Conditions to accession to the Scheme

Implementation of the APS for RBS will be subject to further due diligence by HM Treasury and its advisers, documentation and satisfaction of applicable conditions (including the application criteria and asset eligibility criteria of the APS), adoption of a prescribed remuneration policy in respect of assets managed under the APS and conditions precedent to accession in the APS, including state aid, regulatory and shareholder approvals. RBS has agreed to provide certain information to HM Treasury in the period prior to RBS's proposed accession, including

(i) an indicative list of the Proposed Assets, with a view to agreeing such list by 30 April 2009;

(ii) information and data relating to the Proposed Assets for the purposes of HM Treasury's due diligence; and

(iii) access to RBS's premises, books, records, senior executives, relevant personnel and professional advisers.

As at the date of this document, the timing for the implementation of the APS is still to be determined. The proposed entry by the Company into the APS and any associated capitalisation would constitute a related party transaction for the purposes of the Listing Rules requiring the approval of Independent Shareholders. Therefore if the Company is to participate in the APS, it will convene a further general meeting to seek Independent shareholder approval and a circular explaining the proposals and containing the relevant general meeting notice will be sent to Shareholders in due course, although no prospectus will be required.

Terms and conditions of the B Shares

At the same time as it announced RBS plc's intended participation in the APS, RBS announced that it expected to issue to HM Treasury (i) £6.5 billion of B Shares at the time of entering into the APS and (ii) a further £13 billion of B Shares on or after implementation of the APS. RBS also announced that it had been agreed with HM Treasury that, at RBS's option, a further £6 billion of B Shares could be issued to HM Treasury. The detailed terms of this option remain to be agreed between RBS and HM Treasury. All of these B Shares are expected to constitute Core Tier 1 capital and will be issued on the same terms. Key terms of the B Shares are expected to include the following:

- Nominal value and issue price: £0.50 per B Share.

- Ranking: on a winding-up, holders of the B Shares will rank pari passu with the holders of any other classes of Ordinary Shares and junior to preference shareholders. For these purposes, on a winding-up each holder of a B Share will be deemed to hold one Ordinary Share of RBS for every B Share held at the date of the commencement of such winding-up (the "Winding Up Ratio").

- Dividend entitlement: non-cumulative dividends will be declared at the discretion of RBS, which dividends shall be paid in priority to any dividend on any other class of ordinary share capital. If declared, dividends on the B Shares will be paid semi-annually in arrear. The first such semi-annual dividend in respect of any financial year shall be payable on the date that is three business days after the record date in respect of the interim dividend payable on the Ordinary Shares in respect of such financial year, if such interim dividend on the Ordinary Shares is to be paid. The second such semi-annual dividend in respect of any financial year shall be payable on the date that is three business days after the record date in respect of the final dividend payable on the Ordinary Shares in respect of such financial year, if such final dividend on the Ordinary Shares is to be paid. If no interim dividend on the Ordinary Shares is to be paid in respect of any financial year, the first semi-annual dividend on the B Shares in respect of such financial year, if to be paid, shall be payable on 31 October in such financial year, and if no final dividend on the Ordinary Shares is to be paid in respect of any financial year the second semi-annual dividend on the B Shares in respect of such financial year, if to be paid, shall be payable on 31 May in the immediately following financial year.

- If to be paid, the dividend per B Share will be equivalent to (i) 7 per cent. of the issue price of each B Share multiplied by the number of days in the period from (and including) the immediately preceding Relevant Date (as defined below) or, in the case of the first semi annual dividend in 2009, the date of issue to (but excluding) the current Relevant Date divided by 365 (or 366 in a leap year) or (ii) in the case of any second semi-annual dividend in respect of any financial year, if greater and if a dividend or dividends or other distribution(s) is/are paid or made (whether interim or final) on the Ordinary Shares in respect of the period from (but excluding) the Relevant Date falling on (or nearest to) one year prior to the current Relevant

Date to (and including) the current Relevant Date, 250 per cent. (the "Participation Rate") of the aggregate amount of such dividend(s) or distribution(s) per Ordinary Share less the amount of the first semi-annual dividend (if any) paid in respect of such financial year. "Relevant Date" means each date on which RBS pays a semi-annual dividend or, if no such payment has been made, 31 October in respect of the first semi-annual dividend in respect of any financial year and 31 May in the immediately following financial year in respect of the second semi-annual dividend in respect of any financial year.

- Scrip dividends: if RBS decides to pay a dividend on the B Shares in respect of a semi-annual period and either (i) no dividend has been paid on the Ordinary Shares and/or distribution made thereon in respect of the same period or (ii) a dividend has been paid and/or a distribution has been made thereon otherwise than in cash in respect of the same period, RBS may in its discretion determine that the dividend on the B Shares in respect of the corresponding period shall be paid in whole or in part by RBS issuing further B Shares to the holders of B Shares. The number of further B Shares to be issued to each holder shall be such number of B Shares as shall be certified by an independent investment bank (acting as expert) to equal the value in cash of the dividend otherwise payable on the B Shares in respect of the relevant period.

- Restrictions following non-payment of dividend: if RBS decides not to pay any semi-annual dividend on the B Shares in cash or otherwise, then until such time as semi-annual dividends on the B Shares have been resumed in full RBS will be prohibited from paying dividends or other distributions (whether in cash or otherwise) on, or redeeming, purchasing or otherwise acquiring, (i) its Ordinary Shares or (ii) any other securities of RBS or any other member of the Group ranking or expressed to rank pari passu with the Ordinary Shares and the B Shares on a winding-up, either issued by RBS or, where issued by another member of the Group, where the terms of the securities benefit from a guarantee or support agreement entered into by RBS which ranks or is expressed to rank pari passu with the Ordinary Shares and the B Shares on a winding-up.

- Redemption rights: none, but RBS may purchase the B Shares subject to applicable laws and FSA consent.

- Conversion rights: at any time a holder of a B Share may deliver a notice to RBS requesting conversion of B Shares into Ordinary Shares of RBS. All B Shares shall automatically and mandatorily convert into Ordinary Shares if the volume weighted average trading price of the Ordinary Shares for 20 complete trading days in any 30 trading day period equals or exceeds £0.65 per Ordinary Share. The number of Ordinary Shares to be issued upon conversion will be determined by dividing the aggregate issue price (£0.50 per B Share) of the B Shares being converted by the Conversion Price. The conversion price of the B Shares will be £0.50 (the "Conversion Price").

- Limitations on optional conversion: without prejudice to the provisions above concerning the mandatory conversion of the B Shares, HM Treasury shall not be entitled to exercise its option to convert B Shares into Ordinary Shares to the extent that it holds 75 per cent. or more of the Ordinary Shares or to the extent that the exercise of such option would result in it holding 75 per cent. or more of the Ordinary Shares.

- Voting rights before conversion: holders of the B Shares will only have voting rights in limited circumstances (resolutions varying/abrogating class rights and resolutions to wind up, or in relation to the winding-up of, RBS). If entitled to vote, on a poll holders of B Shares will have two votes for each B Share held. HM Treasury shall not be so entitled to vote the B Shares to the extent the votes cast on such B Shares, together with any other votes which HM Treasury is entitled to cast in respect of any Ordinary Shares held by or on behalf of HM Treasury, would exceed 75 per cent. of the total votes eligible to be cast on a resolution proposed at a general meeting of RBS.

- Voting rights after conversion: HM Treasury shall not be entitled to vote in respect of Ordinary Shares acquired by it as a result of the conversion of B Shares into Ordinary Shares to the extent that votes cast on such Ordinary Shares, together with any other votes which HM Treasury is entitled to cast in respect of any other Ordinary Shares held by or on behalf of HM Treasury, would exceed 75 per cent. of the total votes eligible to be cast on a resolution proposed at a general meeting of RBS.

- Pre-emption rights: HM Treasury shall agree that it shall not exercise any pre-emption rights it may be entitled to as a holder of B Shares in respect of future issues of Ordinary Shares.

- Ordinary Share buy-back: for as long as any B Shares remain outstanding, RBS may not purchase any of its Ordinary Shares.

- Listing: the B Shares will not initially be listed. HM Treasury is entitled to require RBS to seek a listing of the B Shares.

- Adjustment events: the Winding Up Ratio and Participation Rate shall be subject to anti-dilution adjustments. The Conversion Price shall be adjusted in accordance with standard Euro-market anti-dilution adjustments other than customary change of control adjustments or extraordinary dividend adjustments (to the extent compensated by dividends paid at the Participation Rate).

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Second Placing and Open Offer

Background to the Second Placing and Open Offer

In 2008 the Board concluded that the Group needed to strengthen its capital base and to accomplish this two capital raisings were carried out. A £12 billion rights issue was completed in June 2008. Then, due to a severe deterioration in financial markets and economic conditions, a further capital raising totalling £20 billion was completed in December 2008. Of the £20 billion raised in December, £15 billion was in the form of Ordinary Shares, and £5 billion was in the form of Preference Shares purchased entirely by HM Treasury. As a result of this capital raising, HM Treasury acquired approximately 57.9 per cent. of the issued ordinary share capital of the Company. The intention of the Board was that HM Treasury's holding of Preference Shares would be redeemed as soon as practicable.

In the last few weeks of 2008 the continuing dislocation in financial markets and significant uncertainties in credit conditions, together with the sharp deterioration in economic conditions, negatively impacted the trading performance of many financial institutions globally, including RBS. As a result, RBS incurred significant credit impairment losses and credit market write downs.

In view of the above, the Board, in conjunction with HM Treasury, decided to take steps to improve the quality of the Group's capital base by carrying out the Second Placing and Open Offer, and using the proceeds to redeem the Preference Shares held by HM Treasury. Shareholders were able to apply to subscribe for £5.37 billion of new ordinary shares pro rata to their existing shareholdings at a fixed price of 31.75 pence per share by way of the open offer.

The capital restructuring resulting from the Second Placing and Open Offer removed the £0.6 billion annual cost of the preference share dividend and created £5 billion of additional Core Tier 1 capital, which provides a higher quality level of capital support against the impact on the Group's business of any further deterioration in economic and financial market conditions. Following the Second Placing and Open Offer, HM Treasury currently own approximately 70.3 per cent. of the issued ordinary share capital of the company.

Various initiatives, such as the Asset Protection Scheme ("APS") and the Credit Guarantee Scheme, are being progressed by the UK Government to stabilise the UK banking system further and enhance support for the economy. The stated aims of the APS and the Credit Guarantee Scheme are to reinforce the stability of the financial system, to increase confidence and capacity to lend, and in turn to support the recovery of the UK economy. The other initiatives are expected to focus on asset and funding risks which are central to freeing up additional lending capacity whilst augmenting the impact of the capital measures described above.

By participating in the APS, the Group will be able to free up its lending capacity. Consequently, the Group announced on 26 February 2009 that it would increase its lending to UK homeowners and businesses subject to the Group's ordinary course credit and pricing criteria on the Group's normal contractual terms by £25 billion over the next 12 months. The increased lending will be split £9 billion to mortgage lending and the remaining £16 billion to business lending. Similar levels of lending have been committed to in 2010. This latest commitment supersedes the lending commitments the Group announced in October 2008 and in January 2009 and builds on NatWest's and RBS plc's recently announced pledge to continue to provide committed overdrafts and no increased pricing for small business customers until at least the end of 2009. These lending commitments will cease if RBS does not participate in the APS and Credit Guarantee Scheme by 1 June 2009 or will reduce if it participates in only one of the APS or Credit Guarantee Scheme prior to 1 June 2009.

While redemption of the Preference Shares allows the resumption of a sustainable and progressive dividend policy for the Ordinary Shares (it was a term of the Preference Shares that no such dividends may be paid while the Preference Shares were in issue), it is not the Board's intention to pay a dividend on the Ordinary Shares in 2009. If the B Shares are issued as announced on 26 February 2009, no cash dividend may be paid on the Ordinary Shares unless the cash dividend payable in respect of the same period on the B Shares is paid in full, and no scrip dividend may be paid on the Ordinary Shares unless the cash or scrip dividend payable in respect of the same period on the B Shares is paid in full.

Impact of the Second Placing and Open Offer and the Preference Share Redemption on RBS

The effect of the Second Placing and Open Offer and the Preference Share Redemption was to improve the quality of RBS's regulatory capital by increasing RBS's Core Tier 1 ratio; the Tier 1 ratio was not affected. The Second Placing and Open Offer and the Preference Share Redemption had no other impact on RBS's balance sheet. The Preference Shares carried a coupon of 12 per cent. at the discretion of the Board while the new shares issued in connection with the Second Placing and Open Offer rank pari passu with the existing shares of the company for any dividend payments. Accordingly, other than the elimination of the annual distribution at the discretion of the Board in respect of the preference share coupon, and the inclusion of the new shares in the payment of any future dividends on RBS's ordinary shares, the Placing and Open Offer and Preference Share Redemption had no impact on the Group's income statement.

Sale of Bank of China Investment

On 14 January 2009, the Group (through RBS China Investment Sarl.) sold its entire 4.26 per cent stake in Bank of China for HKD18.4 billion.

Debt Tender and Exchange Offer

On 26 March 2009, RBS Financing Limited ("RBSF"), a subsidiary of the Group, launched a cash tender offer in the United States (the "RBSF US Tender Offer") for any and all of the outstanding securities of ten different series previously issued by the Group and certain of its affiliates. Concurrently therewith, RBSF also launched a cash tender offer outside of the United States (the "RBSF Non-US Tender Offer") for five different series of securities previously issued by The Royal Bank and certain of its affiliates and an offer outside of the United States to exchange (the "RBSF Exchange Offer") any or all of the outstanding securities of fourteen different series previously issued by The Royal Bank and certain of its affiliates for new senior unsecured notes of The Royal Bank.

The RBSF Tender Offers and the RBSF Exchange Offer expired on 22 April 2009. In the RBSF US Tender Offer, an aggregate of approximately US $4.1 billion principal amount of securities were validly tendered, resulting in an aggregate purchase consideration paid for the tendered securities of approximately US $1.7 billion.

In the RBSF Non-US Tender Offer, an aggregate of approximately €2.3 billion principal amount of Euro-denominated securities and approximately US $264 million principal amount of Dollar-denominated securities were validly tendered, resulting in aggregate purchase consideration paid for the tendered securities of approximately €1.1 billion and US $100 million, respectively.

In the RBSF Exchange Offer, an aggregate of approximately £3.5 billion principal amount of securities were validly offered for exchange and exchanged for new senior unsecured notes of The Royal Bank in an aggregate principal amount of approximately £1.8 billion.

Litigation Update

Note 32 of the Notes on the Accounts provides disclosure regarding, among other things, litigation claims in the United Kingdom. With respect to the claims regarding unarranged overdraft charges, the Group and other banks appealed against the orders of the High Court. On 26 February 2009, the Court of Appeal delivered its judgment and rejected the appeals. The House of Lords has granted the Group and other banks leave to appeal the Court of Appeal's decision. That further appeal is scheduled to take place on 23 June 2009. With respect to class action complaints filed in the United States District Court for the Southern District of New York, complaints relating to public filings in connection with the broad class of RBS publicly traded securities between 26 June 2007 and 19 January 2009 are included in the description of class action complaints in Note 32.

Strategic review

RBS has embarked on a sweeping restructuring of the Group that will fit its activities to the goals outlined above. While the details of the strategic plan will be refined over the coming weeks to take account of the final agreements reached with HM Treasury in respect of RBS's participation in the APS, the plan is expected to include the following:

- RBS will create a "Non-Core" division of RBS during the second quarter of 2009, separately managed, but within the existing legal structures of the Group and matrix managed to donating divisions where necessary. RBS currently intends that this division will have approximately £240 billion of third party assets, £145 billion of derivative balances and £155 billion of risk-weighted assets, comprising individual assets, portfolios and businesses of the Group that RBS intends to run off or dispose of during the next three to five years. The specific timetable will vary in each case but will be as fast as RBS judges consistent with optimising shareholder value and risk. Approximately 90 per cent. of the Non-Core division will consist of GBM assets, primarily linked to proprietary portfolios, excess risk concentrations and illiquid 'originate and hold' asset portfolios. The rest of the Non-Core division will be risk concentrations, 'out of footprint' assets and smaller, less advantaged businesses within our Regional Markets activities across the world. As part of this effort it is intended that RBS's representation in approximately 36 of the 54 countries it operates in around the world will be significantly reduced or sold. RBS will remain strong in all its major existing global hubs, however. Given the commercial and human sensitivity of these issues, detail on this will not be given until the interim results. The income, expenses, impairments and credit market and other trading asset write downs associated with the Non-Core Division in 2008 were approximately £3.9 billion, £1.1 billion, £3.2 billion and £9.2 billion respectively.

- In addition to eliminating expenses associated with the Non-Core division, RBS has launched a restructuring plan to make efficiency savings across the Group, aimed at achieving run-rate reductions by 2011 of greater than £2.5 billion (16 per cent. of 2008 cost base) at constant exchange rates. This will involve a wide range of re-engineering and other measures and, regrettably, reductions in employment. This target excludes any impact of inflation, incentive pay movements or cost reductions arising from business exits or the impact of new projects (if any). It includes the £0.5 billion of ABN AMRO integration benefits previously announced but not reflected in 2008 expenses. We will book one-off charges against these actions over the next three years, with run-rate cost savings expected to provide ‘payback’ in 1.5 to 1.75 years.

- RBS plans to retain each of its major business divisions since it believes, with intensive restructuring, they can meet the attractive business characteristics outlined as targets above. In many cases the restructuring of these businesses to achieve RBS’s goals will be far-reaching, nevertheless. The greatest element of restructuring will be in GBM as signalled above. A substantial shrinkage of size, product and geographic scope will take place. This should leave GBM positioned profitably around those of its existing core strengths that rest on profitable customer franchise business with significantly less illiquid risk overall.

- At all times RBS will responsibly compare the value to RBS of each of its businesses with realistic alternatives and take different action if they prove compelling. However, the distressed and pessimistic state of markets for financial assets and businesses offers little immediate encouragement in that regard.

- Alongside our business restructuring activities will be substantive changes to management and internal processes. There will continue to be changes of personnel as RBS promotes and reassigns internal talent and add to its ranks externally. The Manufacturing division will re-align with the customer facing businesses. Businesses will have clear bottom-line returns, allocated equity and balance sheet and funding goals. While RBS drives for profit, there will be a concentration on earnings quality and sustainability, driven by strategic plans, to ensure alignment of our businesses to their markets and their risk targets. People evaluation and incentivisation will meet best practice levels to support the revised mission of the Company. This will be underpinned by a full suite of risk and funding constraints, including concentration limits.

RBS has already begun this major change programme. To carry it through in parallel with running its continuing business in difficult markets will test management capacity. RBS expects to be successful overall, though it will inevitably have setbacks and make mistakes along the way. But there is no alternative. RBS must change in a far-reaching way. If it does that, the strength, quality and power that are already present in RBS business across the world will have the chance to shine through once again.

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Relationship with major shareholder

The UK Government currently owns 70.3 per cent. of the issued ordinary share capital of RBS. The UK Government's shareholding in RBS is currently held by the Solicitor for the Affairs of HM Treasury as nominee for HM Treasury and managed by UK Financial Investments Limited ("UKFI"), a company wholly owned by HM Treasury. No formal relationship agreement has been concluded between RBS and the UK Government, although the relationship falls within the scope of the framework document between HM Treasury and UKFI published on 2 March 2009. This document states that UKFI will manage the UK financial institutions in which HM Treasury holds an interest "on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies (including with respect to individual lending or remuneration decisions)", which is designed to ensure that control of the relationship is not abused. This document also makes it clear that such UK financial institutions will continue to be separate economic units with independent powers of decision and "will continue to have their own independent boards and management teams, determining their own strategies and commercial policies (including business plans and budgets)."

These goals are consistent with the stated public policy aims of the UK Government, as articulated in a variety of public announcements.

In the framework document between UKFI and HM Treasury, UKFI stated that its goal was to "develop and execute an investment strategy for disposing of the investments [in the banks] in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition."

It was also stated that UKFI intended to "engage robustly with banks' boards and management, holding both strategy and financial performance to account, and taking a strong interest in getting the incentives structures right on the board and beyond—accounting properly for risk and avoiding inefficient rewards for failure."

In this connection, RBS announced on 17 February 2009 that it had reached an agreement with UKFI in respect of certain changes to its remuneration policy. RBS has also undertaken to conduct a review of its strategy and UKFI has been actively engaged in reviewing the output of this review.

In connection with its proposed access to the APS (further details of which are set out above), RBS has undertaken to provide lending to creditworthy UK homeowners and businesses in a commercial manner. RBS's compliance with this commitment will be subject to a monthly reporting process to the UK Government. The lending commitment does not require RBS to lend in excess of its single name or sectoral risk concentration limits or otherwise to engage in uncommercial practices.

RBS, in common with other financial institutions, also works closely with a number of UK Government departments and agencies on various industry-wide initiatives that are intended to support the UK Government's objective of supporting stability in the wider financial system.

Other than in relation to these areas, however, the UK Government has confirmed publicly that its intention is to allow the financial institutions in which it holds an interest to operate their business independently.

Following consultation with UKFI and other major institutional shareholders the Nominations Committee recommended the appointment of Philip Hampton to the Board of Directors, which approved the appointment.

As a result of the UK Government's holding, the UK Government and UK Government controlled bodies became related parties of the Group. The Group enters into transactions with many of these bodies on an arms' length basis.

The Group is not a party to any transaction with the UK Government or any UK Government controlled body involving goods or services which is material to the Group, or any such transaction that is unusual in its nature or conditions. To the Group's knowledge, the Group does not believe it is a party to any transaction with the UK Government or any UK Government controlled body involving goods or services which is material to the UK Government or any UK Government controlled body, however, given the nature and extent of the UK Government controlled bodies, the Group may not know whether a transaction is material for such a party.

Any outstanding loans made by the Group to or for the benefit of the UK Government or any UK Government controlled body, were made on an arm's length basis and (A) such loans were made in the ordinary course of business, (B) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and (C) did not involve more than the normal risk of collectibility or present other unfavorable features. The Group notes, however, that with respect to outstanding loans made by the Group to or for the benefit of the UK Government or any UK Government controlled body, there may not exist any comparable transactions with other persons.

Trading and outlook

On 26 February 2009, RBS announced its results for the year ended 31 December 2008. In that announcement, RBS made the following statement about current trading and outlook for 2009.

''To make any forecast is hazardous beyond the expectation that 2009 will be a very tough year for the world economy. RBS, in common with all banks, will see some erosion of underlying income levels as a result of weaker business activity and low interest rates squeezing savings margins whilst credit costs rise, probably sharply. We hope that markets will be less disrupted than in 2008, with lower associated write-downs, but time will tell. 2009 has, in fact, started positively for our businesses. At the time of writing, RBS is in discussions with the UK Government concerning participation in the proposed Asset Protection Scheme (''APS''). This would be subject to shareholder vote in due course. The result of the APS discussions will have a material impact on RBS's outlook, positive or negative depending on outcome. More information will be made available as soon as practicable.

Notwithstanding the challenging outlook, our businesses all around the world are inherently good and fully engaged in sustaining as robust a performance as the environment permits. And the strategic restructuring we have embarked on will see high levels of activity designed to reposition RBS successfully.''

Annual General Meeting held on 3 April 2009

On 3 April 2009, the Group held its Annual General Meeting. At the meeting, shareholders voted to (i) elect Philip Hampton, Stephen Hester, John McFarlane and Arthur 'Art' Ryan as directors of the Group, (ii) re-appoint Deloitte LLP as the company's auditor and (iii) authorise the Audit Committee to fix the remuneration of the auditors. All other resolutions presented to shareholders at the Annual General Meeting were also approved by shareholders.

General Meeting held on 3 April 2009

On 3 April 2009, the Group held a General Meeting in connection with the Second Placing and Open Offer. At the meeting, all resolutions presented to shareholders were approved by shareholders.

Competition
The Group faces strong competition in all the markets it serves. However, the global banking crisis has reduced the capacity of many institutions to lend and has resulted in the withdrawal or disappearance of a number of market participants and significant consolidation of competitors, particularly in the US and UK. Competition for retail deposits has intensified significantly reflecting the difficulties in the wholesale money markets.

Competition for corporate and institutional customers in the UK is from UK banks and from large foreign financial institutions who are also active and offer combined investment and commercial banking capabilities. In asset finance, the Group competes with banks and specialised asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets the Group competes with the large domestic banks active in these markets and with the major international banks.

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

In the personal banking segment the Group competes with UK banks and building societies, major retailers and life assurance companies. In the mortgage market the Group competes with UK banks and building societies. A number of competitors have either left or scaled back their lending in the mortgage and unsecured markets. The Group’s life assurance businesses compete with Independent Financial Advisers and life assurance companies.

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

In Europe, Asia and the Middle East, the enlarged Group now competes in retail banking with local and international banks. In a number of these markets there are regulatory barriers to entry or expansion, and the state ownership of banks. Competition is generally intensifying as more players enter markets that are perceived to be de-regulating and offer significant growth potential.

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

RBS Insurance competes in personal lines insurance and, to a limited extent, in commercial insurance. There is strong competition from a range of insurance companies which now operate telephone and internet direct sales businesses. Competition in the UK motor market remains particularly intense, and price comparison internet sites now play a major role in the marketplace. RBS Insurance also competes with local insurance companies in the direct motor insurance markets in Spain, Italy and Germany.

In Ireland, Ulster Bank and First Active compete in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market.

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

Risk factors

Set out below are certain risk factors which could affect the Group's future results and cause them to be materially different from expected results. The Group's results are also affected by competition and other factors. The factors discussed in this report should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

The company may face the risk of full nationalisation and under such circumstances shareholders may lose the full value of their shares.

Under the provisions of the Banking Act, substantial powers have been granted to HM Treasury, the Bank of England and the Financial Services Authority (FSA) as part of the Special Resolution Regime to stabilise banks that are in financial difficulties. The Special Resolution Regime gives the authorities three stabilisation options: private sector transfer, of all or part of the business of a UK-incorporated institution with permission to accept deposits (a "relevant entity"); transfer of all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England; and temporary public ownership (nationalisation) of the relevant entity or its UK-incorporated holding company.

The purpose of the stabilising options is to address the situation where all or part of the business of the relevant entity has encountered, or is likely to encounter, financial difficulties. Accordingly, the stabilisation options may only be exercised if the FSA is satisfied that a relevant entity such as the Group's banking subsidiaries, including the Royal Bank and NatWest, (i) is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the Financial Services and Markets Act 2000 (the "FSMA") and (ii) having regard to timing and other relevant circumstances it is not reasonably likely that action will be taken that will enable the relevant entity to satisfy those threshold conditions. The threshold conditions are conditions which an FSA-authorised institution must satisfy in order to retain its FSA authorisation. They are relatively wide-ranging and deal with most aspects of a relevant entity's business, including, but not limited to, minimum capital resource requirements. It is therefore possible that the FSA may exercise one of the stabilisation options before a relevant entity is in severe difficulties and before an application for insolvency or an administration order could be made.

The stabilisation options may be exercised by means of powers to transfer property, rights or liabilities of a relevant entity and shares and other securities issued by a relevant entity. HM Treasury may also take the parent company of a relevant entity (such as the Company) into temporary public ownership provided that certain conditions set out in Section 82 of the Banking Act are met. Temporary public ownership is effected by way of a share transfer order.

If HM Treasury makes the decision to take the holding company of a relevant entity into temporary public ownership, it may take various actions in relation to securities issued by the holding company, including:

- to transfer securities free from any contractual or legislative restrictions on transfer;
- to transfer securities free from any trust, liability, or encumbrance;
- to extinguish rights to acquire securities;
- to delist securities; or
- to convert securities into another form or class.

Where HM Treasury has made a share transfer order in respect of securities issued by the holding company of a relevant entity, HM Treasury may make an order providing for the property, rights or liabilities of the holding company or of any relevant entity in the holding company group to be transferred.

Shareholders may have a claim for compensation under one of the compensation schemes provided for in the Banking Act. For the purposes of determining an amount of compensation, an independent valuer must disregard actual or potential financial assistance provided by the Bank of England or HM Treasury.

There can be no assurance that Shareholders would thereby recover compensation promptly and/or equal to any loss actually incurred.

If the Group were made subject to the Special Resolution Regime and a partial transfer of the Group's business was effected, the nature and mix of the assets and liabilities not transferred may adversely affect its financial condition and increase the risk that the Group may eventually become subject to administration or insolvency proceedings.

Over the last six months, the UK Government has taken action under the Banking (Special Provisions) Act 2008 in respect of a number of UK financial institutions, including in extreme circumstances, full and part nationalisation. There have been concerns in the market in recent months regarding the risks of such nationalisation in relation to RBS and other UK banks. If economic conditions in the UK or globally continue to deteriorate, or the events described in the following risk factors occur to such an extent that they have a materially adverse impact on the financial condition, perceived or actual credit quality, results of operations or business of any of the relevant entities in the Group, the UK Government may decide to take similar action in relation to RBS. Given the extent of HM Treasury's and the Bank of England's powers under the Banking Act, it is difficult to predict what effect such actions might have on RBS and any securities issued by it. However, potential impacts may include full nationalisation of RBS and the total loss of value in RBS shares.

If RBS is unable to participate in the APS, or the operation of the APS fails to have the desired effect on RBS's financial and capital position, the Company may face the increased risk of full nationalisation. If the costs of participation outweigh the benefits, this could have a negative impact on RBS's business, earnings and financial prospects and its Share price may suffer.

On 26 February 2009, RBS announced its intention to participate in the APS. However, its ability to participate in the APS is subject to the satisfaction of a number of conditions which may not be satisfied, including, among others, the completion of due diligence by (and to the satisfaction of) HM Treasury, the receipt of certain regulatory approvals (including European Commission State Aid clearance), the approval of a majority of RBS's Independent Shareholders, finalisation of the terms of the APS and RBS's participation therein and the satisfaction by RBS of certain specified application criteria. The failure to satisfy these conditions could result in RBS being unable to participate in the APS and therefore failing to obtain protection against stressed losses through the economic cycle as well as failing to improve its capital ratios at the RBS consolidated Group level. The result of this may mean intervention by the UK Government, which could include full nationalisation, under which circumstances any compensation payable to Shareholders would be subject to the provisions of the Banking Act, and Shareholders may lose the full value of their Shares.

Furthermore, even if RBS is able to participate in the APS, there can be no assurance that such participation will enable RBS to achieve all of the stated goals of the APS. While the APS is expected to limit losses associated with assets to be covered by the APS, RBS would remain fully exposed in respect of a specified "first loss" amount and exposed to 10 per cent. of losses exceeding that "first loss" amount. In addition, RBS would continue to be exposed to the risk of losses, impairments and write-downs with respect to assets not covered by the APS. Although RBS would have the option to obtain an additional £6 billion in capital from HM Treasury (in the form of a subscription for further B Shares) there can be no assurance that such additional capital, together with RBS's strengthened capital position as a result of the Placing and Open Offer, and the capital resulting from the proposed issue of the £6.5 billion and £13 billion of B Shares, will be sufficient to maintain the Group's capital ratios in the event of further losses, which could cause RBS's business, results of operation and financial condition to suffer, its credit rating to drop, its ability to lend and access funding to be further limited, its cost of funding to increase and its Share price to decline, any of which would increase the risk of the full nationalisation of RBS.

In addition, there can be no assurance that the costs to RBS of its participation in the APS will not outweigh any benefits received. For example, RBS has agreed in principle that if it accedes to the APS, it will give up the right to certain tax losses and allowances which may affect the after-tax returns of the Group in future years. As a result of RBS's agreement to give up such UK tax losses and allowances it is likely that RBS will pay UK corporation tax in earlier accounting periods than it would otherwise have done.

The Group's businesses, earnings and financial condition have been and will continue to be affected by the continued deterioration in the global economy, as well as ongoing instability in the global financial markets.

The performance of the Group has been and will continue to be influenced by the economic conditions of the countries in which it operates, particularly the United Kingdom, the United States and other countries throughout Europe and Asia. Recessionary conditions are present in many of these countries, including the United Kingdom and the United States, and such conditions are expected to continue or worsen over the near to medium term. In addition, the global financial system is continuing to experience the difficulties which first manifested themselves in August 2007, and the financial markets have deteriorated significantly since the bankruptcy filing by Lehman Brothers in September 2008. These conditions have led to severe and continuing dislocation of financial markets around the world and unprecedented levels of illiquidity, resulting in the development of significant problems at a number of the world's largest corporate institutions operating across a wide range of industry sectors, many of whom are the Group's customers and counterparties in the ordinary course of its business. In response to this economic instability and illiquidity in the market, a number of governments, including the UK Government, the governments of the other EU member states and the US Government, have intervened in order to inject liquidity and capital into the financial system, and, in some cases, to prevent the failure of these institutions.

Despite such measures, the volatility and disruption of the capital and credit markets have continued at unprecedented levels, and global recessionary conditions are expected to continue. These conditions have produced and will continue to produce downward pressure on stock prices and on availability and cost of credit for financial institutions, including the Group, and will continue to impact on the credit quality of the Group's customers and counterparties. Such conditions, alone or in combination with regulatory changes or actions of other market participants, may cause the Group to experience further reductions in business activity, increased funding costs and funding pressures, lower share prices, decreased asset values, additional write downs and impairment charges and lower profitability or to incur losses.

In addition, the Group will continue to be exposed to the risk of loss if major corporate borrowers or counterparty financial institutions fail or are otherwise unable to meet their obligations. The Group's performance may also be affected by future recovery rates on assets and the historical assumptions underlying asset recovery rates, which may no longer be accurate given the unprecedented market disruption and general economic instability. The precise nature of all the risks and uncertainties the Group faces as a result of current economic conditions cannot be predicted and many of these risks are outside the Group's control.

Any conversion of the B Shares would significantly increase HM Treasury's ownership interest in RBS, have a corresponding dilutive effect on other RBS Shareholders and could result in the delisting of RBS's securities.
At the same time as RBS announced its proposed participation in the APS, RBS announced that, if it participated in the APS, it would issue £6.5 billion of B Shares to HM Treasury. RBS also announced that it would issue a further £13 billion of B Shares to HM Treasury on or after implementation of the APS, and HM Treasury would grant RBS the option to require HM Treasury to purchase a further £6 billion of B Shares from it. The B Shares, if issued, will rank pari passu with the Ordinary Shares on a winding-up. The B Shares would be convertible, at the option of the holder at any time, into Ordinary Shares at an initial conversion price of £0.50 per Ordinary Share. HM Treasury would agree not to convert any B Shares it holds if, as a result of such conversion, it would hold 75 per cent. or more of the Ordinary Shares, unless the price of the Ordinary Shares is equal to or exceeds £0.65 for a specified period in which case conversion is mandatory in any event. If all £25.5 billion of B Shares are issued, such conversion of the B Shares would significantly increase HM Treasury's ownership interest in RBS up to approximately 84.4 per cent. of the Company's issued share capital, and have a corresponding dilutive effect on other RBS Shareholders (as would the issue of the B Shares themselves in the event of a winding-up) although any such conversion would have no impact on the Group's Tier 1 capital position. Furthermore, a mandatory conversion of the B Shares by HM Treasury would put RBS in breach of the Listing Rules requirement that 25 per cent. of its issued share capital must be in public hands. Although RBS may apply to the UKLA for a waiver in such circumstances, there is no guarantee that such a waiver would be granted, the result of which could be the delisting of RBS from the Official List and potentially other exchanges where its securities are currently listed and traded. In addition, HM Treasury will not be entitled to vote in respect of Ordinary Shares acquired by it as a result of the conversion of B Shares into Ordinary Shares to the extent, but only to the extent, that votes cast on such Ordinary Shares, together with any other votes which HM Treasury is entitled to cast in respect of any other Ordinary Shares held by or on behalf of HM Treasury would exceed 75 per cent. of the total votes eligible to be cast on a resolution presented at a general meeting of the Company.

Lack of liquidity is a risk to the Group's business and its ability to access sources of liquidity has been, and will continue to be, constrained.
Liquidity risk is the risk that a bank will be unable to meet its obligations, including funding commitments, as they fall due. This risk is inherent in banking operations and can be heightened by a number of enterprise specific factors, including an over-reliance on a particular source of funding (including, for example, short term and overnight

funding), changes in credit ratings or market-wide phenomena such as market dislocation and major disasters. Credit markets worldwide have experienced and continue to experience a severe reduction in liquidity and term-funding in the aftermath of events in the US sub-prime residential mortgage market and the current severe market dislocation. Perception of counterparty risk between banks has also increased significantly following the bankruptcy filing by Lehman Brothers. This increase in perceived counterparty risk has led to further reductions in inter-bank lending, and hence, in common with many other banks, the Group’s access to traditional sources of liquidity has been, and may continue to be, restricted.

The Group’s liquidity management focuses on maintaining a diverse and appropriate funding strategy for its operations, controlling the mismatch of maturities and carefully monitoring its undrawn commitments and contingent liabilities. However, the Group’s ability to access sources of liquidity (for example, through the issue or sale of financial and other instruments or through the use of term loans) during the recent period of liquidity stress has been constrained to the point where it, like other banks, has had to rely on shorter term and overnight funding with a consequent reduction in overall liquidity, and to increase its recourse to liquidity schemes provided by central banks.

In addition, there is also a risk that corporate and institutional counterparties with credit exposures may look to reduce all credit exposures to banks, given current risk aversion trends. It is possible that credit market dislocation becomes so severe that overnight funding from non-government sources ceases to be available.

Furthermore, like many banks, the Group relies on customer deposits to meet a considerable portion of its funding requirements and such deposits are subject to fluctuation due to certain factors outside the Group’s control, such as a loss of confidence, competitive pressures or the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors which could result in a significant outflow of deposits within a short period of time. Any material decrease in the Group’s deposits could, particularly if accompanied by one of the other factors described above, have a negative impact on the Group’s liquidity unless corresponding actions were taken to improve the liquidity profile of other deposits or to reduce assets.

The governments of some of the countries in which the Group operates have taken steps to guarantee the liabilities of the banks and branches operating in their respective jurisdiction. Whilst in some instances the operations of the Group are covered by government guarantees alongside other local banks, in other countries this may not necessarily always be the case. This may place subsidiaries operating in those countries, such as Ulster Bank Ireland Ltd, which did not participate in such government guarantee schemes, at a competitive disadvantage to the other local banks and therefore may require the Group to provide additional funding and liquidity support to these operations.

There can be no assurance that these measures, alongside other available measures, will succeed in improving the funding and liquidity in the markets in which the Group operates, or that these measures, combined with any increased cost of any funding currently available in the market, will not lead to a further increase in the Group’s overall cost of funding, which could have an adverse impact on the Group’s financial condition and results of operations or result in a loss of value in RBS shares.

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Governmental support schemes are subject to cancellation, change or withdrawal (on a general or individual basis), which may have a negative impact on the availability of funding in the markets in which the Group operates.
Governmental support schemes are subject to cancellation, change or withdrawal (on a general or individual basis), based on changing economic and political conditions in the jurisdiction of the relevant scheme. Furthermore, certain schemes which have been recently announced have in fact not been fully implemented, or their terms have not yet been finalised. To the extent government support schemes are cancelled, changed or withdrawn in a manner which diminishes their effectiveness, or to the extent such schemes fail to generate additional liquidity or other support in the relevant markets in which such schemes operate, the Group, in common with other banks, may continue to face limited access to, have insufficient access to, or incur higher costs associated with, funding alternatives, which could have a material adverse impact on the Group's business, financial condition, results of operations and prospects and result in a loss of value in RBS shares.

The financial performance of the Group has been and will be affected by borrower credit quality.
Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of the Group's businesses. The outlook for the global economy over the near to medium term has continued to deteriorate, particularly in the UK, the United States and other European economies. For example, there is an expectation of further reductions in residential and commercial property prices, higher unemployment rates and reduced profitability of corporate borrowers. As a result, the Group has seen and expects to continue to see adverse changes in the credit quality of its

borrowers and counterparties, with increasing delinquencies, defaults and insolvencies across a range of sectors. This trend has led and may lead to further impairment charges, higher costs, additional write downs and losses for the Group or result in a loss of value in RBS shares.

The actual or perceived failure or worsening credit of the Group's counterparties has adversely affected and could continue to adversely affect the Group.
The Group's ability to engage in routine funding transactions has been and will continue to be adversely affected by the actual or perceived failure or worsening credit of its counterparties, including other financial institutions and corporate borrowers. The Group has exposure to many different industries and counterparties and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients. As a result, defaults by, or even the perceived creditworthiness of or concerns about, one or more corporate borrowers, financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the Group or by other institutions. Many of these transactions expose the Group to credit risk in the event of default of the Group's counterparty or client. In addition, the Group's credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure that is due to the Group, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those currently experienced. Any such losses could have a material adverse effect on the Group's results of operations and financial condition or result in a loss of value in RBS shares.

The Group's earnings and financial condition have been, and its future earnings and financial condition are likely to continue to be, affected by depressed asset valuations resulting from poor market conditions.
Financial markets are currently subject to significant stress conditions, where steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity, as exemplified by recent events affecting asset backed collateralised debt obligations (CDOs), the US sub-prime residential mortgage market and the leveraged loan market. In dislocated markets, hedging and other risk management strategies have proven not to be as effective as they are in normal market conditions due in part to the decreasing credit quality of hedge counterparties, including monoline and other insurance companies and credit derivative product companies. Severe market events have resulted in the Group recording large write-downs on its credit market exposures in 2007 and 2008. The Group expects that the deterioration in economic and financial market conditions will lead to further impairment charges and write-downs during the current financial year. Moreover, recent market volatility and illiquidity has made it difficult to value certain of the Group's exposures. Valuations in future periods, reflecting, among other things, then-prevailing market conditions and changes in the credit ratings of certain of the Group's assets, may result in significant changes in the fair values of the Group's exposures, even in respect of exposures, such as credit market exposures, for which the Group has previously recorded write-downs. In addition, the value ultimately realised by the Group may be materially different from the current or estimated fair value. Any of these factors could require the Group to recognise further significant write-downs or realise increased impairment charges, any of which may adversely affect its capital position, its financial condition and its results of operations or result in a loss of value in RBS shares.

The value or effectiveness of any credit protection that the Group has purchased from monoline and other insurers and other market counterparties (including credit derivative product companies) depends on the value of the underlying assets and the financial condition of the insurers and such counterparties.
The Group has credit exposure arising from over-the-counter derivative contracts, mainly credit default swaps (CDSs), which are carried at fair value. The fair value of these CDSs, as well as the Group's exposure to the risk of default by the underlying counterparties, depends on the valuation and the perceived credit risk of the instrument against which

protection has been bought. Since 2007, monoline and other insurers and other market counterparties (including credit derivative product companies) have been adversely affected by their exposure to residential mortgage linked and corporate credit products. As a result, their actual and perceived credit worthiness deteriorated significantly in 2008 and may continue to be so impacted in 2009. If the financial condition of these counterparties or their actual and perceived credit worthiness deteriorates further, the Group may record further credit valuation adjustments on the CDSs bought from these counterparties in addition to those already recorded.

Changes in interest rates, foreign exchange rates, bond, equity and commodity prices, and other market factors have significantly affected and will continue to affect the Group's business.
Some of the most significant market risks the Group faces are interest rate, foreign exchange, bond, equity and commodity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs, the effect of which may be heightened during periods of liquidity stress, such as those experienced in recent months. Changes in currency rates, particularly in the sterling-US dollar and sterling-euro exchange rates, affect the value of assets, liabilities, income and expenses denominated in foreign currencies and the reported earnings of the Group's non-UK subsidiaries (principally ABN AMRO, Citizens and RBS Greenwich Capital) and may affect income from foreign exchange dealing. The performance of financial markets may affect bond, equity and commodity prices and, therefore, cause changes in the value of the Group's investment and trading portfolios. This has been the case during the period since August 2007, with market disruptions and volatility resulting in significant reductions in the value of such portfolios. While the Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed, it is difficult, particularly in the current environment, to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Group's financial performance and business operations or result in a loss of value in RBS shares.

The Group's borrowing costs and its access to the debt capital markets depend significantly on its credit ratings.
On 19 January 2009, S&P affirmed the long-term and short-term counterparty credit ratings for the Royal Bank at A+ and A-1 respectively. The outlook for all entities of the Group was confirmed as stable, reflecting S&P's view that the Group is of systemic importance to the UK banking system and that S&P now explicitly factor four notches of uplift into their long-term counterparty credit rating on the Group. At the same time S&P lowered its ratings on the Group's hybrid capital issues to BB from BBB, additionally the BB rating was placed under CreditWatch with negative implications. On the same date, Fitch affirmed the Group and the Royal Bank's Long-term and Short-term Issuer Default Ratings at AA- and F1+ respectively and downgraded the Group and the Royal Bank's individual ratings to E from B/C. The outlook for the Issuer Default Ratings remains stable reflecting Fitch's expectation of continued strong government support for the Group. The Group's support rating was upgraded from 1 to 5 and its support floor revised to AA- from No Floor. Fitch also downgraded the Group and the Royal Bank's Tier 1 preference shares to BB- from A+, and upper tier 2 hybrid capital instruments issued by Group companies to BB from A+ and placed all of these securities on Rating Watch Negative. Moody's on 20 January 2009 downgraded the senior unsecured rating of the Royal Bank to Aa3 from Aa1 with a negative outlook. The Group's senior debt rating was downgraded to A1 from Aa2 again with a negative outlook. The Bank Financial Strength Rating was lowered to C- from B and remains under review for further possible downgrade. The short term P-1 ratings of both the Group and the Royal Bank were affirmed. The outlook for all Group entities incorporates Moody's view on the long-term credit profile of the Group beyond the current government support-phase as well as their view of the very high probability of on-going support from the Aaa-rated UK Government. Any future reductions in the long-term credit ratings of the Group or one of its principal subsidiaries (particularly the Royal Bank) could further increase its borrowing costs. Any further reductions may also limit the Group's access to the capital markets and trigger additional collateral requirements in derivative contracts and other secured funding arrangements. Credit ratings of the Group and the Royal Bank are also important to the Group when competing in certain markets, such as over-the-counter derivatives. As a result, any further reductions in the Group's or the Royal Bank's credit ratings could adversely affect its access to liquidity and competitive position, increase its funding costs and have a negative impact on the Group's earnings and financial condition or result in a loss of value in RBS shares.

The Group's business performance could be adversely affected if its capital is not managed effectively.

Effective management of the Group's capital is critical to its ability to operate its businesses, to grow organically and to pursue its strategy. The Group is required by regulators in the United Kingdom, the United States, the Netherlands and in other jurisdictions in which it undertakes regulated activities, to maintain adequate capital. The maintenance of adequate capital is also necessary to enhance the Group's financial flexibility in the face of continuing turbulence and uncertainty in the global economy. Accordingly, the purpose of the First Placing and Open Offer and the issue of the Preference Shares was to allow the company to strengthen its capital position. As at 31 December 2008 the Group's Tier 1 and Core Tier 1 capital ratios were 10.0 per cent. and 6.8 per cent. respectively, using the Basel II methodology. Although the net proceeds of the First Placing and Open Offer and the Preference Share Issue strengthened the Group's capital base significantly, and the net proceeds of the Second Placing and Open Offer were used to redeem the existing £5 billion of Preference Shares and which thereby improved the quality of the Group's capital by increasing the Group's Core Tier 1 capital ratio, any change that limits the Group's ability effectively to manage its balance sheet and capital resources going forward (including, for example, reductions in profits and retained earnings as a result of write-downs or otherwise, increases in risk-weighted assets, delays in the disposal of certain assets or the inability to syndicate loans as a result of market conditions or otherwise) or to access funding sources, could have a material adverse impact on its financial condition and regulatory capital position or result in a loss of value in RBS shares.

The value of certain financial instruments recorded at fair value is determined using financial models incorporating assumptions, judgements and estimates that may change over time or may ultimately not turn out to be accurate.
Under IFRS, the Group recognises at fair value: (i) financial instruments classified as ‘held-for-trading’ or ‘designated as at fair value through profit or loss’; (ii) financial assets classified as ‘available-for-sale’; and (iii) derivatives, each as further described in ‘Accounting Policies’ on page 166 of the financial statements. Generally, to establish the fair value of these instruments, the Group relies on quoted market prices or, where the market for a financial instrument is not sufficiently active, internal valuation models that utilise observable market data. In certain circumstances, the data for individual financial instruments or classes of financial instruments utilised by such valuation models may not be available or may become unavailable due to changes in market conditions, as has been the case during the current financial crisis. In such circumstances, the Group’s internal valuation models require the Group to make assumptions, judgements and estimates to establish fair value. In common with other financial institutions, these internal valuation models are complex, and the assumptions, judgements and estimates the Group is required to make often relate to matters that are inherently uncertain, such as expected cash flows, the ability of borrowers to service debt, residential and commercial property price appreciation and depreciation, and relative levels of defaults and deficiencies. Such assumptions, judgements and estimates may need to be updated to reflect changing facts, trends and market conditions. The resulting change in the fair values of the financial instruments has had and could continue to have a material adverse effect on the Group’s earnings and financial condition. Also, recent market volatility and illiquidity has challenged the factual bases of certain underlying assumptions and has made it difficult to value certain of the Group’s financial instruments. Valuations in future periods, reflecting prevailing market conditions, may result in further significant changes in the fair values of these instruments, which could have a negative effect on the Group’s results of operations and financial condition or result in a loss of value in RBS shares.

The Group’s future earnings and financial condition in part depend on the success of the Group’s strategic refocus on core strengths and its disposal programme.
In light of the recently changed global economic outlook, the Group has embarked on a restructuring which focused on achieving appropriate risk-adjusted returns under these changed circumstances, reducing reliance on wholesale funding and lowering exposure to capital intensive businesses. The Group will also continue with its disposal programme and continue to review its portfolio to identify further disposals of certain non-core assets. For further details of these re-structuring plans, please read “Business Review – Strategic Review” on page 9 of this document. Although the proceeds of the Second Placing and Open Offer improved the quality of the Group's capital by replacing the existing £5 billion of Preference Shares with £5 billion of Core Tier 1 capital, the global credit markets remain challenging and the Group’s execution of its current and future strategic plans may not be successful. In connection with the implementation of these plans, the Group may incur restructuring charges, which may be material. Furthermore, if the Group’s plans, including any planned disposals, are not successful or fail to achieve the results expected, the Group’s business, capital position financial condition, results of operations and future prospects may be negatively impacted or this could result in a loss of value in RBS shares.

The Group operates in markets that are highly competitive and consolidating. If the Group is unable to perform effectively, its business and results of operations will be adversely affected.
Recent consolidation among banking institutions in the United Kingdom, the United States and throughout Europe is changing the competitive landscape for banks and other financial institutions. This consolidation, in combination with

the introduction of new entrants into the US and UK markets from other European and Asian countries, could increase competitive pressures on the Group. Moreover, if financial markets continue to be volatile, more banks may be forced to consolidate.

In addition to the effects of consolidation, increased government ownership of, and involvement in, banks generally may have an impact on the competitive landscape in the major markets in which the Group operates. Although, at present, it is difficult to predict what the effects of this increased government ownership and involvement will be or how it will differ from jurisdiction to jurisdiction, such involvement may cause the Group to experience stronger competition for corporate, institutional and retail clients and greater pressure on profit margins. Since the markets in which the Group operates are expected to remain highly competitive in all areas, these and other changes to the competitive landscape could adversely affect the Group's business, margins, profitability and financial condition or result in a loss of value in RBS shares.

The Group has agreed to certain undertakings in relation to the operation of its business in the First Placing and Open Offer Agreement, the Second Placing and Open Offer Agreement and in connection with the proposed APS, which may serve to limit the Group's operations.

Under the terms of the First Placing and Open Offer Agreement, the Group provided certain undertakings aimed at ensuring that the subscription by HM Treasury for the relevant Ordinary Shares and the Preference Shares and the Group's potential participation in the guarantee scheme promoted by HM Treasury as part of its support for the UK banking industry are compatible with the common market under EU law. These undertakings include (i) supporting certain initiatives in relation to mortgage lending and lending to SMEs until 2011, (ii) regulating management remuneration and (iii) regulating the rate of growth of the Group's balance sheet. Under the terms of the Second Placing and Open Offer Agreement, the Group's undertakings in relation to mortgage lending and lending to SMEs were extended to larger commercial and industrial companies in the United Kingdom. These undertakings may serve to limit the Group's operations. In addition, pursuant to the Lending Commitments Letter, the Group is subject to further undertakings, which supersede the lending commitments made to HM Treasury in October 2008 and January 2009 by agreeing to lend £16 billion above the amount the Group had budgeted to lend to UK businesses and £9 billion above the amount the Group had budgeted to lend to UK homeowners in the year commencing 1 March 2009, with a commitment to lend at similar levels in the year commencing 1 March 2010. For a description of these undertakings, please read "Material Contracts" on page 267 of this document.

The Group could fail to attract or retain senior management or other key employees.

The Group's ability to implement its strategy depends on the ability and experience of its senior management and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a negative impact on the Group's business. The Group's future success will also depend on its ability to attract, retain and remunerate highly skilled and qualified personnel competitively with its peers. This cannot be guaranteed, particularly in light of heightened regulatory oversight of banks and heightened scrutiny of, and (in some cases) restrictions placed upon, management compensation arrangements, in particular those in receipt of Government funding (such as the Group). The Group recently announced changes to its compensation structure which included significant reductions in bonuses to be paid in respect of 2008, and limitations on pay rises in 2009. Details of these changes are outlined in the letter from the Chairman of the Remuneration Committee on page 140. In addition to the effects of such measures on the Group's ability to retain senior management and other key employees, the marketplace for skilled personnel is becoming more competitive, which means the cost of hiring, training and retaining skilled personnel may continue to increase. The failure to attract or retain a sufficient number of appropriately skilled personnel could prevent the Group from successfully implementing its strategy, which could have a material adverse effect on the Group's financial condition and results of, operations or result in a loss of value in RBS shares.

Each of the Group's businesses is subject to substantial regulation and oversight. Any significant regulatory developments could have an effect on how the Group conducts its business and on its results of operations and financial condition.

The Group is subject to financial services laws, regulations, administrative actions and policies in each location in which it operates. All of these are subject to change, particularly in the current market environment, where there have been unprecedented levels of government intervention and changes to the regulations governing financial institutions, including recent nationalisations in the United Kingdom, the United States and other European countries. As a result of these and other ongoing and possible future changes in the financial services regulatory landscape (including requirements imposed by virtue of the Group's participation in any government or regulator-led initiatives), the Group expects to face greater regulation in the United Kingdom, the United States, the Netherlands and other countries in which it operates, including throughout the rest of Europe.

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Compliance with such regulations may increase the Group's capital requirements and costs and have an adverse impact on its business, the products and services it offers and the value of its assets or result in a loss of value in RBS shares.

Other areas where governmental policies and regulatory changes could have an adverse impact include, but are not limited to:

- the monetary, interest rate, capital adequacy and other policies of central banks and regulatory authorities;
- general changes in government or regulatory policy or changes in regulatory regimes that may significantly influence investor decisions in particular markets in which the Group operates or may increase the costs of doing business in those markets;
- changes to financial reporting standards;
- other general changes in the regulatory requirements, such as prudential rules relating to the capital adequacy framework and the imposition of onerous compliance obligations, restrictions on business growth or pricing and requirements to operate in a way that prioritises objectives other than shareholder value creation;
- changes in competition and pricing environments;
- further developments in the financial reporting environment;
- differentiation amongst financial institutions by governments with respect to the extension of guarantees to bank customer deposits and the terms attaching to such guarantees, including requirements for the entire Group to accept exposure to the risk of any individual member of the Group, or even third party participants in guarantee schemes, failing;
- implementation of, or costs related to, local customer or depositor compensation or reimbursement schemes;
- transferability and convertibility of currency risk;
- expropriation, nationalisation and confiscation of assets;
- changes in legislation relating to foreign ownership; and

- other unfavourable political, military or diplomatic developments producing social instability or legal uncertainty which, in turn, may affect demand for the Group's products and services.

The Group's results have been and could be further adversely affected in the event of goodwill impairment.
The Group capitalises goodwill, which is calculated as the excess of the cost of an acquisition over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Acquired goodwill is recognised initially at cost and subsequently at cost less any accumulated impairment losses. As required by IFRS, the Group tests goodwill for impairment annually or more frequently, at external reporting dates, when events or circumstances indicate that it might be impaired. An impairment test involves comparing the recoverable amount (the higher of value in use and fair value less cost to sell) of an individual cash generating unit with its carrying value. The value in use and fair value of the Group's cash generating units are affected by market conditions and the performance of the economies in which the Group operates. Where the Group is required to recognise a goodwill impairment, it is recorded in the Group's income statement, although it has no effect on the Group's regulatory capital position. For the year ended 31 December 2008, the Group recorded a £32.6 billion accounting write-down of goodwill and other intangibles relating to prior year acquisitions.

The Group may be required to make further contributions to its pension schemes if the value of pension fund assets is not sufficient to cover potential obligations.
The Group maintains a number of defined benefit pension schemes for past and current employees. Pensions risk is the risk that the liabilities of the Group's various defined benefit pension schemes which are long term in nature will exceed the schemes' assets, as a result of which the Group is required or chooses to make additional contributions to the schemes. The schemes' assets comprise investment portfolios that are held to meet projected liabilities to the scheme members. Risk arises from the schemes because the value of these asset portfolios and returns from them may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In these circumstances, the Group could be obliged, or may choose, to make additional contributions to the schemes, and during recent periods, the Group has voluntarily made such contributions. Given the current economic and financial market difficulties and the prospects for them to continue over the near and medium term, the Group may be required or elect to make further contributions to the pension schemes and such contributions could be significant and have a negative impact on the Group's capital position results of operations or financial condition or result in a loss of value in RBS shares.

The Group is and may be subject to litigation and regulatory investigations that may impact its business.
The Group's operations are diverse and complex and it operates in legal and regulatory environments that expose it to potentially significant litigation, regulatory investigation and other regulatory risk. As a result, the Group is, and may in the future be, involved in various disputes, legal proceedings and regulatory investigations in the United Kingdom, the United States and other jurisdictions, including class-action litigation. Furthermore, the Group, like many other financial institutions, has come under greater regulatory scrutiny over the last year and expects that environment to continue for the foreseeable future, particularly as it relates to compliance with new and existing corporate governance, employee compensation, conduct of business, anti-money laundering and anti-terrorism laws and regulations, as well as the provisions of applicable sanctions programmes. Disputes, legal proceedings and regulatory investigations are subject to many uncertainties, and their outcomes are often difficult to predict, particularly in the earlier stages of a case or investigation. Adverse regulatory action or adverse judgements in litigation could result in restrictions or limitations on the Group's operations or result in a material adverse effect on the Group's reputation or results of operations or result in a loss of value in RBS shares. For details about certain litigation and regulatory investigations in which the Group is involved, see Note 32 on the financial statements.

Operational risks are inherent in the Group's operations.
The Group's operations are dependent on the ability to process a very large number of transactions efficiently and accurately while complying with applicable laws and regulations where it does business. The Group has complex and geographically diverse operations and operational risk and losses can result from internal or external fraud, errors by employees or third-parties, failure to document transactions properly or to obtain proper authorisation, failure to comply with applicable regulatory requirements and conduct of business rules (including those arising out of anti-money laundering and anti-terrorism legislation, as well as the provisions of applicable sanctions programmes), equipment failures, natural disasters or the inadequacy or failure of systems and controls, including those of the Group's suppliers or counterparties. Although the Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures, to identifying and rectifying weaknesses in existing procedures and to training staff, it is not possible to be certain that such actions have been or will be effective in controlling each of the operational risks faced by the Group. Any weakness in these systems or controls, or any breaches or alleged breaches of applicable laws or regulations could have a materially negative impact on the Group's business, reputation, results of operations and share price. Notwithstanding anything contained in this risk factor, it should not be taken as implying that either the company or the Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA.

The Group is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes in the jurisdictions in which it operates.
The Group's activities are subject to tax at various rates around the world computed in accordance with local legislation and practice. Action by governments to increase tax rates or to impose additional taxes would reduce the Group's profitability. Revisions to tax legislation or to its interpretation might also affect the Group's results in the future.

The acquisition of a majority shareholding in the Group by HM Treasury in December 2008 could lead to certain adverse tax consequences for the Group.
The acquisition by HM Treasury of a majority shareholding in the Group in consequence of the First Placing and Open Offer could, in certain circumstances, have adverse tax consequences which could affect the post-tax profitability of the Group. However, if the Group enters into the APS it has agreed, in principle, to give up the right to certain UK tax losses and allowances and this may limit the adverse tax consequences of the acquisition by HM Treasury of a majority shareholding in the Group.

The Group’s insurance businesses are subject to inherent risks involving claims.
Future claims in the Group’s general and life assurance business may be higher than expected as a result of changing trends in claims experience resulting from catastrophic weather conditions, demographic developments, changes in mortality and other causes outside the Group’s control. These trends could affect the profitability of current and future insurance products and services. The Group reinsures some of the risks it has assumed and is accordingly exposed to the risk of loss should its reinsurers become unable or unwilling to pay claims made by the Group against them.

The Group’s operations have inherent reputational risk.
Reputational risk, meaning the risk to earnings and capital from negative public opinion, is inherent in the Group’s business. Negative public opinion can result from the actual or perceived manner in which the Group conducts its business activities or from actual or perceived practices in the banking and financial industry. Negative public opinion may adversely affect the Group’s ability to keep and attract customers and, in particular, corporate and retail depositors. The Group cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In the United Kingdom and in other jurisdictions, the Group is responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.
In the United Kingdom, the Financial Services Compensation Scheme (the “Scheme”) was established under the FSMA and is the UK’s statutory fund of last resort for customers of authorised financial services firms. The Scheme can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it and, if the Banking Bill is enacted in its current form, may be required to make payments either in connection with the exercise of a stabilisation power or in exercise of the bank insolvency procedures under that Bill. The Scheme is funded by levies on firms authorised by the FSA, including the Group. In the event that the Scheme raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the Group may have a material impact on its results of operations and financial condition. During the financial year ended 31 December 2008, the Group made a provision of £150 million related to a levy by the Scheme.

In addition, to the extent that other jurisdictions where the Group operates have introduced or plan to introduce similar compensation, contributory or reimbursement schemes (such as in the United States with the Federal Deposit Insurance Corporation), the Group may make further provisions and may incur additional costs and liabilities, which may negatively impact its financial condition and results of operations or result in a loss of value in RBS shares.

The Group’s business and earnings may be affected by geopolitical conditions.
The performance of the Group is significantly influenced by the geopolitical and economic conditions prevailing at any given time in the countries in which it operates, particularly the United Kingdom, the United States and other countries in Europe and Asia. For example, the Group has a presence in countries where businesses could be exposed to the risk of business interruption and economic slowdown following the outbreak of a pandemic, or the risk of sovereign default following the assumption by governments of the obligations of private sector institutions. Similarly the Group faces the heightened risk of trade barriers, exchange controls and other measures taken by sovereign governments which may impact a borrower’s ability to repay. Terrorist acts and threats and the response to them of governments in any of these countries could also adversely affect levels of economic activity and have an adverse effect upon the Group's business.

The restructuring proposals for ABN AMRO are complex and may not realise the anticipated benefits for the Group.

The restructuring plan in place for the integration and separation of ABN AMRO into and among the businesses and operations of the consortium members is complex, involving substantial reorganisation of ABN AMRO's operations and legal structure. In addition, the plan contemplates activities taking place simultaneously in a number of businesses and jurisdictions. Although integration efforts are well underway and are being advanced on a number of fronts, the implementation of the reorganisation and the realisation of the forecast benefits within the planned timescales, particularly given current market and economic conditions, remains challenging, although the Group remains confident that such goals will be achieved. Execution of the restructuring requires management resources previously devoted to the Group businesses and the retention of appropriately skilled ABN AMRO staff. The Group may not realise the benefits of the acquisition or the restructuring when expected or to the extent projected. The occurrence of any of these events, including as a result of staff losses or performance issues, may have a negative impact on the Group's financial condition and results of operations. It is not expected that the Dutch State's acquisition of Fortis Bank Nederland's shares in RFS Holdings, which was effected in December 2008, will materially affect the integration benefits envisaged by the Group.

The recoverability of certain deferred tax assets recognised by the Group depend on the Group's ability to generate sufficient future taxable profits and there being no adverse changes to tax legislation.
In accordance with IFRS, the Group has recognised deferred tax assets on losses available to relieve future profits from tax only to the extent that it is probable that they will be recovered. The losses are quantified on the basis of current tax legislation and are subject to change in respect of the rate of tax or the rules for computing taxable profits and allowable losses. Failure to generate sufficient future taxable profits or changes in tax legislation may reduce the recoverable amount of the recognised deferred tax assets.

RBS's ability to pay dividends on or make other distributions in respect of the Ordinary Shares will depend on the availability of distributable reserves and may be limited by the terms of the B Shares.
RBS's ability to pay dividends is limited under UK company law, which limits a company to only paying cash dividends to the extent that it has distributable reserves and cash available for this purpose. As a holding company, RBS's ability to pay dividends in the future is affected by a number of factors, principally its ability to receive sufficient dividends from subsidiaries. The payment of dividends to RBS by its subsidiaries is, in turn, subject to restrictions, including certain regulatory requirements and the existence of sufficient distributable reserves and cash in RBS's subsidiaries. The ability of these subsidiaries to pay dividends and RBS's ability to receive distributions from its investments in other entities are subject to applicable local laws and regulatory requirements and other restrictions, including, but not limited to, applicable tax laws and covenants in some of RBS's debt facilities. These laws and restrictions could limit the payment of future dividends and distributions to RBS by its subsidiaries, which could restrict RBS's ability to fund other operations or to pay, in due course, a dividend to holders of the Existing Shares or the New Shares.

In addition, if the B Shares are issued, no cash dividend may be paid on the Ordinary Shares unless the cash dividend payable in respect of the same period on the B Shares is paid in full, and no scrip dividend may be paid on the Ordinary Shares unless the cash or scrip dividend payable in respect of the same period on the B Shares is paid in full.

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Key financials

for the year ended 31 December	2008 £m	2007 £m	2006 £m
Total income	25,868	30,366	28,002
Operating (loss)/profit before tax	(40,667)	9,832	9,186
(Loss)/profit attributable to ordinary shareholders	(24,137)	7,303	6,202
Cost: income ratio	208.9%	45.9%	44.6%
Basic (loss)/earnings per share (pence) (1)	(145.7p)	64.0p	54.4p

at 31 December	2008 £m	2007 £m	2006 £m
Total assets	2,401,652	1,840,829	856,832
Loans and advances to customers	874,722	828,538	466,893
Deposits	897,556	994,657	516,365
Owners' equity	58,879	53,038	40,227
Risk asset ratio – Tier 1 (2)	10.0%	7.3%	7.5%
– total	14.1%	11.2%	11.7%

Notes:

(1) Prior year per share data have been restated to reflect the rights issue in June 2008 and the capitalisation issue in September 2008.

(2) 2008 data are on a Basel II basis; data for 2007 and 2006 are on a Basel I basis.

Overview of results

As discussed on page 2, the results of ABN AMRO are fully consolidated in the Group's financial statements. Consequently, the statutory results of RBS for the year ended 31 December 2007 and 2008 include the results of ABN AMRO for 76 days and the full year respectively. The interests of the State of the Netherlands and Santander in RFS Holdings are included in minority interests.

Summary consolidated income statement for the year ended 31 December 2008

	2008 £m	2007 £m	2006 £m
Net interest income	18,675	12,069	10,596
Fees and commissions receivable	9,831	8,278	7,116
Fees and commissions payable	(2,386)	(2,193)	(1,922)
Other non-interest income	(6,578)	6,125	6,239
Insurance net premium income	6,326	6,087	5,973
Non-interest income	7,193	18,297	17,406
Total income	25,868	30,366	28,002
Operating expenses	54,033	13,942	12,480
(Loss)/profit before other operating charges and impairment	(28,165)	16,424	15,522
Insurance net claims	4,430	4,624	4,458

Impairment losses	8,072	1,968	1,878
Operating (loss)/profit before tax	(40,667)	9,832	9,186
Tax	(2,323)	2,044	2,689
(Loss)/profit after tax from continuing operations	(38,344)	7,788	6,497
Profit/(loss) from discontinued operations, net of tax	3,971	(76)	-
(Loss)/profit for the year	(34,373)	7,712	6,497
Minority interests	(10,832)	163	104
Other owners	596	246	191
(Loss)/profit attributable to ordinary shareholders	(24,137)	7,303	6,202
Basic earnings per ordinary share (1)	(145.7p)	64.0p	54.4p
Diluted earnings per ordinary share	(145.7p)	63.4p	53.9p

Note:

(1) Prior year data have been restated to reflect the rights issue in June 2008 and the capitalisation issue in September 2008.

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2008 compared with 2007

Operating loss

Operating loss before tax was £40,667 million compared with an operating profit of £9,832 million in 2007. The results have been adversely affected by the write-down of goodwill and other assets, a substantial decline in non-interest income, a number of specific losses such as counterparty failures, and a marked increase in the credit impairment charge, reflecting weakness in financial markets and a deteriorating global economy.

Losses from credit market exposures increased to £7,781 million, compared with £1,410 million in 2007, with the great majority incurred in the first half of the year. Write-down of goodwill and other assets was £32,581 million. Other one-off items amounted to a credit of £1,674 million, 25% higher than in 2007, principally as a result of a £1,232 million increase in the carrying value of own debt carried at fair value.

Loss attributable to ordinary shareholders was £24,137 million, compared with an attributable profit of £7,303 million in 2007.

Total income

Total income declined by 15% to £25,868 million, with a significant deterioration experienced during the second half of the year principally as a result of £5.8 billion of trading asset write-downs, counterparty failure and incremental reserving within GBM. While income increased in 2008 in Global Transaction Services and Regional Markets, and held steady in Insurance, a significant reduction occurred in Global Banking & Markets, where a strong performance in rates, currencies and commodities was offset by marked deterioration in credit markets and equities.

Net interest income

Net interest income increased by 55% to £18,675 million, with average loans and advances to customers up 61% and average customer deposits up 53%. Group net interest margin fell from 2.32% to 2.12% largely reflecting tightened margins within Regional Markets as market interest rates fell, with deposit markets remaining competitive and price adjustments on lending taking some time to feed through to the back book.

Non-interest income

Non-interest income was severely affected by the weakness in financial markets experienced over the course of the year, particularly in the fourth quarter. Non-interest income decreased to £7,193 million principally due to the credit market write-downs of £7,781 million offset by a movement in the fair value of own debt of £1,232 million. While the decline was particularly marked in GBM's credit markets and equities businesses, with reduced business volumes and mounting mark-to-market trading losses, Regional Markets also saw non-interest income fall in the latter part of the year as declining consumer confidence led to lower demand for credit and other financial products.

Operating expenses

Total operating expenses rose to £54,033 million, with cost growth in the Group's core retail and commercial banking franchises offset by efficiency programmes and a significant reduction in Global Banking & Markets staff costs. Integration and restructuring costs were £1,357 million compared with £108 million in 2007. Write-down of goodwill and other assets was £32,581 million.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, decreased by 4% to £4,430 million, reflecting improved risk selection, better claims management and the non-recurrence of the severe floods experienced in 2007 and as a result of movements in financial market values.

Impairment losses

Impairment losses increased to £8,072 million in 2008, compared with £1,968 million in 2007. The Group experienced a pronounced deterioration in impairments in the second half of the year, as financial stress spread to a broad range of customers. The greatest increase in impairments occurred in GBM, where fourth quarter impairments totalled £2,938 million, including a loss of approximately £900 million on the Group's exposure to LyondellBasell. However, the Regional Markets businesses in all geographies also experienced a noticeable increase in impairments in the second half, particularly in the UK and Irish corporate and US personal segments.

Impairments represented 0.44% of gross loans and advances, excluding reverse repos, in the first half but reached 1.27% in the second half. For 2008 as a whole, impairments amounted to 0.82% of loans and advances, excluding reverse repos, compared with 0.28% in 2007. Risk elements in lending and potential problem loans at 31 December 2008 represented 2.52% of gross loans and advances to customers, excluding reverse repos, compared with 1.64% a year earlier. Provision coverage was 51%, compared with 57% at 31 December 2007 reflecting the higher proportion of secured loans included in risk elements in lending and potential problem loans.

Credit market losses

Losses for 2008 relating to the Group's previously identified credit market exposures totalled £7,781 million, net of hedging gains of £1,642 million. This includes impairment losses of £466 million incurred on credit market assets reclassified out of the 'held-for-trading' category in line with the amendments to IAS 39 'Financial Instruments: Recognition and Measurement' issued in October. While the majority of these write-downs were incurred in the first half of 2008, the severity of the financial market dislocation intensified in the fourth quarter, resulting in further losses in particular on the Group's structured credit portfolios.

Write-down of goodwill and other intangible assets

After reviewing the carrying value of goodwill and other purchased intangible assets, the Group has recorded an impairment charge of £32,581 million. Of this charge, £23,348 million relates to part of the goodwill in respect of the acquisition of ABN AMRO, while other significant impairments have been recorded on part of the Citizens/Charter One goodwill of £4,382 million, part of the NatWest goodwill (principally allocated to Global Banking & Markets) of £2,742 million and other goodwill of £720 million. Other intangible asset impairments of £1,389 million principally relate to the write-down in the value of customer relationships recognised on the acquisition of ABN AMRO.

These impairments have no cash impact, and minimal impact on the Group's capital ratios.

Other non-operating items

Integration and restructuring costs totalled £1,357 million, primarily reflecting the integration of ABN AMRO into the Group, while the amortisation of purchased intangibles increased to £582 million from £124 million.

Taxation

The Group recorded a tax credit of £2,323 million in 2008, compared with a tax charge of £2,044 million in 2007. The effective tax rate for 2008 was 5.7% compared with 20.8% in 2007.

Earnings

Basic earnings per ordinary share decreased from 64.0p to (145.7p).

The number of shares in issue increased to 39,456 million at 31 December 2008, compared with 10,006 million in issue at 31 December 2007, reflecting the Group's capital raisings in June and December and the capitalisation issue in lieu of the interim dividend for 2008.

2007 compared with 2006

Profit

Profit before tax was up 7%, from £9,186 million to £9,832 million. The results of ABN AMRO are included from the date of acquisition, 17 October 2007.

Total income

The Group achieved strong growth in income during 2007. Total income was up 8% or £2,364 million to £30,366 million, notwithstanding the significant impact of the developments in global credit markets in the second half of 2007.

Net interest income increased by 14% to £12,069 million and represents 40% of total income (2006 – 38%). Average loans and advances to customers grew by 23% and average customer deposits grew by 25%.

Non-interest income increased by £891 million to £18,297 million and represents 60% of total income (2006 – 62%).

Net interest margin

The Group's net interest margin at 2.32% was down from 2.53% in 2006.

Operating expenses

Operating expenses increased by 12% to £13,942 million. Integration costs were £108 million compared with £134 million in 2006.

Cost:income ratio

The Group's cost:income ratio was 45.9% compared with 44.6% in 2006.

Net insurance claims

Bancassurance and general insurance claims, after reinsurance, increased by 4% to £4,624 million reflecting adverse weather conditions in the summer of 2007.

Impairment losses

Impairment losses rose 5% to £1,968 million, compared with £1,878 million in 2006.

Risk elements in lending and potential problem loans represented 1.64% of gross loans and advances to customers excluding reverse repos at 31 December 2007 (2006 – 1.57%).

Provision coverage of risk elements in lending and potential problem loans was 57% (2006 – 62%).

Taxation

The effective tax rate for 2007 was 20.8% (2006 – 29.3%). The headline rate is lower than the standard rate of UK corporation tax of 30% principally due to certain non-taxable capital gains and changes to deferred tax balances following the change in rate of corporation tax.

Earnings and dividends

Basic earnings per ordinary share increased by 18%, from 54.4p to 64.0p.

A final dividend of 19.3p per ordinary share was recommended and paid, giving a total dividend for the year of 27.8p, an increase of 10%.

Balance sheet

Total assets were £1,840.8 billion at 31 December 2007. The acquisition of ABN AMRO in October 2007 increased assets by £774.5 billion, with the balance accounted for largely by growth in our lending to customers and in trading assets.

Lending to customers, excluding repurchase agreements and stock borrowing ("reverse repos"), increased in 2007 by 70% or £282.2 billion to £686.2 billion. Customer deposits, excluding repurchase agreements and stock lending ("repos"), grew by 71% or £227.2 billion to £547.5 billion.

Capital ratios at 31 December 2007 were 7.3% (Tier 1) and 11.2% (Total).

Bonus issue

In May 2007, the Group capitalised £1,576 million of its share premium account by way of a bonus issue of two new ordinary shares of 25p each for every one held.

Profitability

The after-tax return on ordinary shareholders' equity, which is based on profit attributable to ordinary shareholders and average ordinary shareholders' equity, was 18.8% compared with 18.5% in 2006.

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Analysis of results

Net interest income

	2008	2007	2006
	£m	£m	£m
Interest receivable	49,522	32,252	24,688
Interest payable	(30,847)	(20,183)	(14,092)
Net interest income	18,675	12,069	10,596
	%	%	%
Gross yield on interest-earning assets of the banking business	5.61	6.19	5.90
Cost of interest-bearing liabilities of the banking business	(3.79)	(4.36)	(3.85)
Interest spread of the banking business	1.82	1.83	2.05
Benefit from interest-free funds	0.30	0.49	0.48
Net interest margin of the banking business	2.12	2.32	2.53

Yields, spreads and margins of the banking business	%	%	%
Gross yield (1)			
Group	5.61	6.19	5.90
UK	5.72	6.69	6.13
Overseas	5.54	5.52	5.50
Interest spread (2)			
Group	1.82	1.83	2.05
UK	1.92	2.30	2.37
Overseas	1.76	1.20	1.47
Net interest margin (3)			
Group	2.12	2.32	2.53
UK	2.39	2.55	2.68
Overseas	1.91	1.99	2.26
The Royal Bank of Scotland plc base rate (average)	4.67	5.51	4.64
London inter-bank three month offered rates (average):			
Sterling	5.51	6.00	4.85
Eurodollar	2.92	5.29	5.20
Euro	4.63	4.28	3.08

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.

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Business review continued

Average balance sheet and related interest

	2008			2007 - Restated		
	Average balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets						
Loans and advances to banks						
– UK	19,039	939	4.93	21,133	1,024	4.85
– Overseas	31,388	1,417	4.51	12,654	546	4.31
Loans and advances to customers						
– UK	319,696	19,046	5.96	268,911	18,506	6.88
– Overseas	393,405	22,766	5.79	175,301	10,062	5.74
Debt securities						
– UK	33,206	1,276	3.84	10,883	600	5.51
– Overseas	85,625	4,078	4.76	31,792	1,514	4.76
Total interest-earning assets						
– banking business (2, 3)	882,359	49,522	5.61	520,674	32,252	6.19
– trading business (4)	425,454			313,110		
Total interest-earning assets	1,307,813			833,784		
Non-interest-earning assets (2, 3)	732,872			289,188		
Total assets	2,040,685			1,122,972		
Percentage of assets applicable to overseas operations	48.6%			38.0%		
Liabilities and owners' equity						
Deposits by banks						
– UK	46,217	1,804	3.90	52,951	2,234	4.22
– Overseas	113,592	4,772	4.20	31,073	1,172	3.77
Customer accounts: demand deposits						
– UK	99,852	2,829	2.83	93,764	3,296	3.52
– Overseas	70,399	1,512	2.15	30,739	1,031	3.35
Customer accounts: savings deposits						
– UK	42,870	1,708	3.98	36,334	1,658	4.56
– Overseas	72,473	2,203	3.04	27,645	902	3.26
Customer accounts: other time deposits						
– UK	94,365	4,011	4.25	88,089	4,201	4.77
– Overseas	105,660	4,097	3.88	43,141	2,100	4.87
Debt securities in issue						
– UK	101,520	4,095	4.03	57,140	3,060	5.36
– Overseas	132,699	5,846	4.41	49,848	2,627	5.27

Subordinated liabilities						
– UK	26,300	1,356	5.16	23,502	1,300	5.53
– Overseas	12,385	788	6.36	4,509	230	5.10
Internal funding of trading business						
– UK	(85,664)	(3,445)	4.02	(68,395)	(3,307)	4.84
– Overseas	(18,090)	(729)	4.03	(7,454)	(321)	4.31
Total interest-bearing liabilities						
– banking business (2, 3)	814,578	30,847	3.79	462,886	20,183	4.36
– trading business (4)	466,610			316,453		
Total interest-bearing liabilities	1,281,188			779,339		
Non-interest-bearing liabilities:						
Demand deposits						
– UK	45,472			18,416		
– Overseas	9,721			14,455		
Other liabilities (3, 4)	645,760			267,403		
Owners' equity	58,544			43,359		
Total liabilities and owners' equity	2,040,685			1,122,972		
Percentage of liabilities applicable to overseas operations	46.8%			35.9%		

Notes:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.

(2) Interest-earning assets and interest-bearing liabilities include the Retail bancassurance assets and liabilities attributable to policyholders.

(3) Interest income and interest expense do not include interest on financial assets and liabilities designated as at fair value through profit or loss.

(4) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

The 2007 comparative amounts have been restated for the netting of certain derivative asset and derivative liability balances with the London Clearing House, the finalisation of the ABN AMRO acquisition accounting and for the classification of Banco Real as a discontinued operation.

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Business review continued

Average balance sheet and related interest

	2006 - Restated		
	Average balance £m	Interest £m	Rate %
Assets			
Loans and advances to banks			
– UK	15,934	681	4.27
– Overseas	7,237	237	3.27
Loans and advances to customers			
– UK	239,086	15,141	6.33
– Overseas	121,092	6,977	5.76
Debt securities			
– UK	12,816	598	4.67
– Overseas	22,032	1,054	4.78
Total interest-earning assets			
– banking business (2, 3)	418,197	24,688	5.90
– trading business (4)	202,408		
Total interest-earning assets	620,605		
Non-interest-earning assets (2, 3)	199,898		
Total assets	820,503		
Percentage of assets applicable to overseas operations	35.2%		
Liabilities and owners' equity			
Deposits by banks			
– UK	35,985	1,393	3.87
– Overseas	28,772	1,228	4.27
Customer accounts: demand deposits			
– UK	86,207	2,428	2.82
– Overseas	13,113	441	3.36
Customer accounts: savings deposits			
– UK	30,933	1,058	3.42
– Overseas	19,766	529	2.68
Customer accounts: other time deposits			
– UK	67,126	2,807	4.18
– Overseas	36,177	1,636	4.52
Debt securities in issue			
– UK	45,829	2,210	4.82
– Overseas	25,249	1,076	4.26
Subordinated liabilities			
– UK	23,873	1,226	5.14
– Overseas	2,639	160	6.06
Internal funding of trading business			
– UK	(44,475)	(1,893)	4.26
– Overseas	(4,930)	(207)	4.20
Total interest-bearing liabilities			
– banking business (2, 3)	366,264	14,092	3.85

– trading business (4)	204,810
Total interest-bearing liabilities	571,074
Non-interest-bearing liabilities:	
Demand deposits	
– UK	17,909
– Overseas	11,668
Other liabilities (3, 4)	182,976
Owners’ equity	36,876
Total liabilities and owners’ equity	820,503
Percentage of liabilities applicable to overseas operations	32.3%

Notes:

(1) The analysis into UK and Overseas has been compiled on the basis of location of office.

(2) Interest-earning assets and interest-bearing liabilities include the Retail bancassurance assets and liabilities attributable to policyholders.

(3) Interest income and interest expense do not include interest on financial assets and liabilities designated as at fair value through profit or loss.

(4) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

The 2006 comparative amounts have been restated for the netting of certain derivative asset and derivative liability balances with the London Clearing House.

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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.

	2008 over 2007 (restated) Increase/(decrease) due to changes in:			2007 (restated) over 2006 (restated) Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m	Average volume £m	Average rate £m	Net change £m
Interest-earning assets						
Loans and advances to banks						
UK	(103)	18	(85)	243	100	343
Overseas	845	26	871	217	92	309
Loans and advances to customers						
UK	3,221	(2,681)	540	1,985	1,380	3,365
Overseas	12,621	83	12,704	3,112	(27)	3,085
Debt securities						
UK	906	(230)	676	(98)	100	2
Overseas	2,564	-	2,564	465	(5)	460
Total interest receivable of the banking business						
UK	4,024	(2,893)	1,131	2,130	1,580	3,710
Overseas	16,030	109	16,139	3,794	60	3,854
	20,054	(2,784)	17,270	5,924	1,640	7,564
Interest-bearing liabilities						
Deposits by banks						
UK	271	159	430	(706)	(135)	(841)
Overseas	(3,452)	(148)	(3,600)	(94)	150	56
Customer accounts: demand deposits						
UK	(204)	671	467	(227)	(641)	(868)
Overseas	(956)	475	(481)	(591)	1	(590)
Customer accounts: savings deposits						
UK	(276)	226	(50)	(206)	(394)	(600)
Overseas	(1,367)	66	(1,301)	(241)	(132)	(373)
Customer accounts: other time deposits						
UK	(286)	476	190	(962)	(432)	(1,394)
Overseas	(2,500)	503	(1,997)	(332)	(132)	(464)
Debt securities in issue						
UK	(1,932)	897	(1,035)	(587)	(263)	(850)
Overseas	(3,714)	495	(3,219)	(1,248)	(303)	(1,551)
Subordinated liabilities						
UK	(148)	92	(56)	19	(93)	(74)
Overseas	(489)	(69)	(558)	(99)	29	(70)
Internal funding of trading business						

UK	751	(613)	138	1,129	285	1,414
Overseas	430	(22)	408	109	5	114
Total interest payable of the banking business						
UK	(1,824)	1,908	84	(1,540)	(1,673)	(3,213)
Overseas	(12,048)	1,300	(10,748)	(2,496)	(382)	(2,878)
	(13,872)	3,208	(10,664)	(4,036)	(2,055)	(6,091)
Movement in net interest income						
UK	2,200	(985)	1,215	590	(93)	497
Overseas	3,982	1,409	5,391	1,298	(322)	976
	6,182	424	6,606	1,888	(415)	1,473

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Non-interest income

	2008 £m	2007 £m	2006 £m
Fees and commissions receivable	9,831	8,278	7,116
Fees and commissions payable	(2,386)	(2,193)	(1,922)
(Loss)/income from trading activities	(8,477)	1,292	2,675
Other operating income (excluding insurance net premium income)	1,899	4,833	3,564
	867	12,210	11,433
Insurance premium income	6,626	6,376	6,243
Reinsurers' share	(300)	(289)	(270)
	6,326	6,087	5,973
	7,193	18,297	17,406

2008 compared with 2007

Non-interest income, decreased by 61%, £11,104 million to £7,193 million. Non-interest income was severely affected by the weakness in financial markets experienced over the course of the year. While the decline was particularly marked in Global Banking & Market's credit markets and equities businesses, with reduced business volumes and mounting mark-to-market trading losses, Regional Markets also saw non-interest income fall in the latter part of the year as declining consumer confidence led to lower demand for credit and other financial products.

Excluding general insurance premium income, non-interest income fell by £11,343 million to £867 million.

Within non-interest income, fees and commissions receivable increased by 19% or £1,553 million, to £9,831 million, while fees and commissions payable increased by 9%, £193 million to £2,386 million.

Income from trading activities was down from £1,292 million to a loss of £8,477 million. Currency trading activities benefited from increased volatility in the markets. However, this improvement was more than offset by substantial credit market write downs during the year.

Other operating income also decreased, falling by 61%, £2,934 million to £1,899 million. This was principally due to a fall in the fair value of securities and other financial assets and liabilities partially offset by profits from the sale of subsidiaries and associates.

Insurance premium income, after reinsurance, increased by 4% to £6,326 million primarily reflecting a full year of ABN AMRO businesses in comparison with 76 days in 2007. This was partly offset by the discontinuation of less profitable partnership contracts.

2007 compared with 2006

Non-interest income increased by 5%, £891 million to £18,297 million, including £810 million from the acquisition of ABN AMRO. Good organic growth was offset by write-downs in Global Banking & Markets in respect of US mortgage-related and leveraged finance exposures. Non-interest income represents 60% of total income (2006 – 62%). Excluding general insurance premium income, non-interest income rose by 7%, £777 million to £12,210 million.

Within non-interest income, fees and commissions receivable increased by 16% or £1,162 million, to £8,278 million, while fees and commissions payable increased by 14%, £271 million to £2,193 million.

Income from trading activities was down from £2,675 million to £1,292 million. Interest rate and currency trading activities benefited from increased volatility and there was good growth from a broadening product range. These improvements were, however, more than offset by credit markets write downs.

Other operating income increased by 36%, £1,269 million to £4,833 million. This was principally due to growth in income from rental and asset-backed activities and principal investments in Global Markets.

General insurance premium income, after reinsurance, increased by 2% to £6,087 million with good growth in policies in the core businesses, particularly in Continental Europe.

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Credit market exposures

	2008			2007	
	Net exposure (1) £m	Write-downs before tax £m	Average price %	Net exposure(1) £m	Average price %
Asset-backed CDOs					
High grade	1,231	1,836	29	2,581	84
Mezzanine	144	1,140	6	1,253	70
	1,375	2,976		3,834	79
Monolines	4,804	3,557	n/a	2,547	n/a
US residential mortgages (2)					
Sub-prime	—	353	n/a	1,292	72
Alt-A	—	1,071	n/a	2,233	83
Other non-agency	—	43	n/a	794	94
	—	1,467		4,319	81
US commercial mortgages (2)	437	95	87	1,809	97
Leveraged finance (2)					
Held-for-trading	103	1,088	64	11,992	96
Loans and receivables	5,920	—	n/a	2,514	n/a
	6,023	1,088		14,506	
CLOs	520	240	81	1,386	93
		9,423			
CDS hedging		(1,642)			
Total net of CDS hedging		7,781			

Note:

(1) Net of hedges and write-downs.

(2) Figures represent the Group's remaining net exposure to its previously reported credit market exposures.

(3) Includes commitments to lend.

Additional disclosures on these and other related exposures can be found in the rest of this document as follows:

Disclosure	Section	Sub-section	Page
Further analysis (1)	Risk management	Credit market and related disclosures	101 – 123
Valuation aspects (1)	Financial statements	Note 11 Financial instruments	186 – 191
Valuation of financial instruments (1)	Financial statements	Critical accounting policies	170 – 171
(general and level 3)		Note 11 Financial instruments	184 – 191

Note:

(1) In preparing these disclosures, the Group took into consideration the leading practice recommendations of the Financial Stability Forum issued in April 2008 and the report of the IASB Advisory Panel 'measuring and disclosing fair value of financial instruments in markets that are no longer active' issued in October 2008.

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Operating expenses

	2008 £m	2007 £m	2006 £m
Administrative expenses:			
Staff costs	10,241	7,338	6,723
Premises and equipment	2,593	1,703	1,421
Other administrative expenses	5,464	2,969	2,658
Total administrative expenses	18,298	12,010	10,802
Depreciation and amortisation	3,154	1,932	1,678
Write-down of goodwill and other assets	32,581	—	—
	54,033	13,942	12,480

2008 compared with 2007

Operating expenses increased by £40,091 million to £54,033 million, primarily reflecting the write-down of goodwill and other assets of £32,581 million following a review of the carrying value of goodwill and other assets. Cost growth in the Group's core retail and commercial banking franchises was offset by efficiency programmes and a significant reduction in Global Banking & Markets staff costs. The 2008 costs reflect a full year of the retained ABN AMRO businesses in comparison with 76 days in 2007.

The Group's ratio of operating expenses to total income was 208.9% compared with 45.9% in 2007, largely reflecting the impact on income of the year's difficult market conditions and the write-down of goodwill and other assets.

2007 compared with 2006

Operating expenses increased by 12%, £1,462 million to £13,942 million including £1,387 million relating to ABN AMRO. Adjusting for this, operating expenses increased by just £75 million, 1%, reflecting tight cost management and the benefits of the Group's manufacturing platform. Further improvements in productivity have supported growth in business volumes, and allowed the Group to maintain high levels of customer satisfaction.

The Group's ratio of operating expenses to total income was 45.9% compared with 44.6% in 2006.

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Integration costs

	2008 £m	2007 £m	2006 £m
Staff costs	503	18	76
Premises and equipment	25	4	10
Other administrative expenses	486	26	32
Depreciation and amortisation	36	60	16
	1,050	108	134

2008 compared with 2007

Integration costs in 2008 were £1,050 million compared with £108 million in 2007. The significant increase reflects a full year of integration costs being incurred in respect of the ABN AMRO acquisition, compared to 76 days in 2007.

Accruals in relation to integration costs are set out below.

	At 31 December 2007 £m	Currency translation adjustments £m	Charge to income statement £m	Utilised during the year £m	At 31 December 2008 £m
Staff costs	4	—	503	(502)	5
Premises and equipment	2	—	25	(26)	1
Other	1	1	522	(521)	3
	7	1	1,050	(1,049)	9

2007 compared with 2006

Integration costs in 2007 were £108 million compared with £134 million in 2006 comprising amortisation of internally developed software and other expenditure. Software costs were previously written-off as incurred under UK GAAP but under IFRS are now amortised over the expected useful lives of up to five years. Software amortisation included in integration costs principally relates to the integration of Churchill, First Active and Citizens' acquisitions, including Charter One which was acquired in August 2004.

Restructuring costs

	2008 £m	2007 £m	2006 £m
Staff costs	251	—	—
Premises and equipment	15	—	—
Other administrative expenses	41	—	—
	307	—	—

Accruals in relation to restructuring costs are set out below.

	At 31 December 2007 £m	Currency translation adjustments £m	Charge to income statement £m	Utilised during the year £m	At 31 December 2008 £m
Staff costs	—	33	251	—	284

Premises and equipment	—	—	15	—	15
Other	—	10	41	—	51
	—	43	307	—	350

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Impairment

	2008 £m	2007 £m	2006 £m
New impairment	8,391	2,310	2,093
less: recoveries of amounts previously written-off	(319)	(342)	(215)
Charge to income statement	8,072	1,968	1,878
Comprising:			
Loan impairment	7,091	1,946	1,877
Impairment of available-for-sale securities	981	22	1
Charge to income statement	8,072	1,968	1,878

2008 compared with 2007
Credit impairment losses increased to £8,072 million in 2008, compared with £1,968 million in 2007. The Group experienced a pronounced deterioration in impairments during the year, as financial stress spread to a broad range of customers. The greatest increase in impairments occurred in Global Banking & Markets. However, the Regional Markets businesses in all geographies also experienced a noticeable increase in impairments during the year, particularly in the UK SME and US personal segments.

Total balance sheet provisions for impairment amounted to £11,016 million compared with £6,452 million in 2007.

Total provision coverage (the ratio of total balance sheet provisions for impairment to total risk elements in lending) decreased from 60% to 52%. The ratio of total balance sheet provisions for impairment to total risk elements in lending and potential problem loans also decreased to 51% compared with 57% in 2007.

2007 compared with 2006
Impairment losses were £1,968 million compared with £1,878 million. Impairment losses in ABN AMRO in the period since acquisition were £103 million. Adjusting for this, impairment losses fell by £13 million, 1%. This reflected improvement in Global Markets and UK Retail & Commercial Banking partially offset by higher impairment in US Retail & Commercial Banking. New impairment losses were up 10%, £217 million to £2,310 million. Recoveries of amounts previously written-off were up £127 million, 59% to £342 million. Consequently the net charge to the income statement was up £90 million, 5% to £1,968 million.

Total balance sheet provisions for impairment, including ABN AMRO, amounted to £6,452 million compared with £3,935 million in 2006.

Total provision coverage (the ratio of total balance sheet provisions for impairment to total risk elements in lending) decreased from 62% to 60%. The ratio of total balance sheet provisions for impairment to total risk elements in lending and potential problem loans decreased to 57% compared with 62% in 2006. This reflects amounts written-off and the slightly lower risk profile of the portfolio.

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Taxation

	2008	2007	2006
	£m	£m	£m
Tax	(2,323)	2,044	2,689
	%	%	%
UK corporation tax rate	28.5	30.0	30.0
Effective tax rate	5.7	20.8	29.3

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

	2008	2007	2006
	£m	£m	£m
Expected tax (credit)/charge	(11,590)	2,950	2,756
Non-deductible goodwill impairment	8,292	12	—
Unrecognised timing differences	274	29	—
Other non-deductible items	330	222	288
Non-taxable items	(491)	(595)	(251)
Taxable foreign exchange movements	80	16	5
Reduction in deferred tax liability following change in the rate of UK corporation tax	—	(189)	—
Foreign profits taxed at other rates	203	(25)	63
Losses in year not recognised	942	2	—
Losses brought forward and utilised	(11)	(11)	14
Adjustments in respect of prior periods	(352)	(367)	(186)
Actual tax (credit)/charge	(2,323)	2,044	2,689

The effective tax rate for the year was 5.7% (2007 – 20.8%; 2006 – 29.3%). The tax credit is lower than that arising from applying the standard rate of UK corporation tax of 28.5% to the loss for the period, principally due to non-deductible goodwill impairment and certain carried forward losses on which no tax relief has been recognised.

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Divisional performance

The divisional results are stated before amortisation of purchased intangible assets, write-down of goodwill and other intangible assets and integration and restructuring costs ('Contribution'). The Group manages costs where they arise. Customer-facing divisions control their direct expenses whilst Manufacturing is responsible for shared costs. In 2008, the Group did not allocate these shared costs between divisions in the day-to-day management of its businesses, and the way in which divisional results are presented reflects this.

	2008 £m	2007 £m	2006 £m
Global Markets			
Global Banking & Markets	(10,515)	3,653	3,811
Global Transaction Services	1,818	1,315	1,186
Total Global Markets	(8,697)	4,968	4,997
Regional Markets			
UK Retail & Commercial Banking	5,679	6,225	5,718
US Retail & Commercial Banking	883	1,479	1,744
Europe & Middle East Retail & Commercial Banking	429	769	675
Asia Retail & Commercial Banking	127	91	67
Total Regional Markets	7,118	8,564	8,204
RBS Insurance	1,020	905	967
Group Manufacturing	(4,793)	(3,773)	(3,523)
Central items	(675)	(552)	(1,231)
Share of shared assets	(300)	(73)	—
RFS Holdings minority interest	41	163	—
Contribution	(6,286)	10,202	9,414
Amortisation of purchased intangibles	(443)	(262)	(94)
Integration and restructuring costs	(1,357)	(108)	(134)
Write-down of goodwill and other intangible assets	(32,581)	—	—
Operating (loss)/profit before tax	(40,667)	9,832	9,186

The performance of each of the divisions is reviewed on pages 35 to 52.

Risk-weighted assets of each division were as follows:

	Basel II 31 December 2008 £bn	Basel II 1 January 2008 £bn	Basel I 31 December 2007 £bn
Global Markets			
Global Banking & Markets	278.5	211.9	188.7
Global Transaction Services	19.6	16.8	15.4
Total Global Markets	298.1	228.7	204.1
Regional Markets			
UK Retail & Commercial Banking	152.5	153.1	179.0
US Retail & Commercial Banking	78.0	53.8	57.1
Europe & Middle East Retail & Commercial Banking	30.9	30.3	36.7

Asia Retail & Commercial Banking	6.4	4.9	3.3
Total Regional Markets	267.8	242.1	276.1
RFS Holdings minority interest	118.0	147.4	119.0
Other	11.9	15.3	9.8
	695.8	633.5	609.0

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Global Markets – Global Banking & Markets

	2008 £m	2007 £m	2006 £m
Net interest income from banking activities	3,894	1,303	1,547
Funding costs of rental assets	(404)	(495)	(519)
Net interest income	3,490	808	1,028
Net fees and commissions receivable	1,288	1,198	859
Income from trading activities	(8,098)	1,789	2,341
Other operating income	800	3,024	2,476
Non-interest income	(6,010)	6,011	5,676
Total income	(2,520)	6,819	6,704
Direct expenses			
– staff costs	2,687	2,134	2,000
– other	1,441	561	402
– operating lease depreciation	224	404	406
	4,352	3,099	2,808
Impairment	3,643	67	85
Contribution	(10,515)	3,653	3,811

	£bn	£bn	£bn
Loans and advances	354.3	254.1	125.7
Reverse repos	96.1	308.9	114.5
Securities	163.2	239.5	109.1
Cash and eligible bills	26.1	26.9	7.5
Other assets	52.2	44.5	24.8
Total third party assets (excluding derivatives mark to market)	691.9	873.9	381.6
Net derivative assets (after netting)	146.0	64.1	17.9
Customer deposits (excluding repos)	105.0	106.7	44.6
Non-performing loans	6.2	1.0	0.5

2008 compared with 2007
Global Banking & Markets (GBM) contribution fell from £3,653 million in 2007 to a loss of £10,515 million. This sharp decline reflected the effect of the market turmoil on the enlarged business which severely affected the division's results in 2008, with a particularly adverse impact in the fourth quarter. GBM incurred £5,776 million of losses, write-downs or reserves largely on credit trading, counterparty risk (including CDPCs), counterparty failure (notably Lehman and Madoff) and sovereign events as the effects of the down-turn widened. In addition, losses on previously identified credit market exposures totalled £7,781 million, including impairments of £466 million on reclassified assets. These were only partly offset by gains on the fair value of own debt.

After credit market write-downs and one-off items and trading asset write-down, GBM recorded negative income of £2,520 million. Total income before credit market write-downs and one-off items (£6,958 million) and trading asset write-downs (£5,776 millions) was £10,214 million, up 19% from 2007. The increase reflects good performances in a number of businesses, most notably in rates and currencies and the inclusion of the ABN AMRO businesses for a full twelve months. Direct costs were up by 40%, with the inclusion of the acquired businesses of ABN AMRO for a full year outweighing reduced bonus payments. Credit impairments rose sharply from a very low level, £67 million, to £3,643 million, resulting in a 2008 operating loss of £10,515 million.

Net interest income grew by £2,682 million to £3,490 million, with the rates business benefiting from the declining interest rate environment. Non-interest income reduced by £12,021 million to negative income of £6,010 million. Fees and commissions increased mainly as a result of the inclusion of the ABN AMRO businesses for a full twelve months partially offset by a decline in origination volumes. Income from trading activities fell from £1,789 million to negative income of £8,098 million primarily as a result of trading asset write-downs and credit market exposures. Other operating income fell sharply from £3,024 million to £800 million, reflecting losses incurred on European loan sales and much reduced gains on other portfolio assets, partially offset by the gain on sale of Angel Trains of £570 million.

By business line, the rates and currencies business achieved a particularly strong performance in 2008, with high volumes of customer activity and flow trading resulting in an increase in income from rates trading to £3,543 million and growth in currencies income to £1,697 million. The Sempra Commodities joint venture performed ahead of expectations in the nine months since its formation, with GBM’s commodities income reaching £778 million for the year.

Equities improved slightly primarily as a result of the inclusion of a full year of ABN AMRO related businesses. However, reduced customer flow and also experienced losses on illiquid trading positions as markets deteriorated rapidly partially offset this increase.

In a reduced market for debt origination, credit markets improved its market positions in a number of key areas such as international bond issuance. Results, however, were severely affected by the continuing market weakness, particularly in the second half of the year.

Asset and portfolio management income remained resilient, but some losses were incurred, including on capital and credit exposure management.

Credit impairments increased sharply to £3,643 million, including £466 million on assets reclassified out of the held for trading category following the amendments to IAS 39 issued in October. Of the total impairment charge, £2,938 million was incurred in the fourth quarter of 2008, including £918 million relating to the Group’s exposure to Lyondell Basell.

GBM’s total third party assets were reduced by £182 billion to £692 billion at 31 December 2008, a reduction of 21% from a year earlier, or 31% at constant exchange rates. Within this total, loans and advances to customers were £354 billion, an increase of 14% at constant exchange rates. This increase was more than offset by significant reductions in reverse repos and securities holdings, both of which have been managed down over the course of the year. Net derivative assets totalled £146 billion, compared with £64 billion at the end of 2007.

Although GBM took steps to reduce underlying risk-weighted assets, these measures were masked by the impact of foreign exchange movements and of Basel II pro-cyclicality, with the result that RWAs at 31 December 2008 totalled £279 billion, up 31% from a year earlier, or 14% at constant exchange rates.

2007 compared with 2006

GBM achieved strong performances in many of its businesses in 2007, with particularly strong growth in interest rate and currency trading activities, but financial results were held back by challenging credit market conditions in the second half of the year. Contribution was £3,653 million, 4% lower than 2006's record result.

Total income of £6,819 million was 2% higher than in 2006, with £394 million as a result of the inclusion of 76 days of GBM related ABN AMRO businesses. Whilst many parts of GBM grew strongly, there were write-downs of our subprime related and leveraged finance positions and additional provisions in response to the weakening credit profile of certain financial guarantors. These losses were partially offset by a reduction in the carrying value of our own debt and by a gain of £712 million realised on the sale of Southern Water.

The strength of GBM and the successful diversification of its product capabilities resulted in a continuation of the strong growth we have achieved in Asia and continental Europe in recent years. In Asia we have now established a solid platform, with good product capabilities and client relationships. In 2007 this resulted in strong Asian income growth, with outstanding growth in our activities in China and Japan. In Europe, income grew considerably, with particularly good results in the Nordic region and in the Iberian Peninsula, where GBM further expanded its strong position in the provision of financing and risk management services to corporates and financial institutions. Income in the UK grew strongly, while results in North America declined as a result of credit market conditions affecting GBM's asset-backed and structured credit businesses.

Net interest income fell by 21% to £808 million. Loans and advances to customers, excluding reverse repos, increased by £128.4 billion as a result of the continued expansion of our customer base outside the UK and the inclusion of GBM related ABN AMRO businesses (£102.7 billion). Customer deposits increased by £62.1 billion, with £48.3 billion from GBM related ABN AMRO businesses.

Net fee income rose by 39% to £1,198 million, reflecting our top tier position in arranging, structuring and distributing large scale financings and the inclusion of GBM related ABN AMRO businesses (£151 million). We achieved particularly strong growth in non-US loan markets.

Income from trading activities declined by £552 million, 24% to £1,789 million, with GBM related ABN AMRO businesses contributing income of £285 million. Strong performances in interest rate and currency trading activities were supplemented by good growth in our broadening product range, including equity derivatives and retail investor products. However, in credit markets, write-downs reflecting the weakening of the US housing market led to a sharp fall in income.

Other operating income increased by £548 million, 22% to £3,024 million, including the successful sale of Southern Water which concluded during the second half. The majority of our remaining private equity portfolio has been sold into a fund, managed by RBS, thereby improving capital efficiency while offering more predictable and stable returns.

Direct expenses increased by 10% to £3,099 million. We continued to invest in expanding our geographical footprint, our infrastructure and our product range.

Portfolio credit risk remained stable and impairment losses declined to £67 million in 2007, with no deterioration in overall corporate credit quality. The liquidity and profitability of our corporate customers remains generally strong.

Total assets increased to £873.9 billion, reflecting the inclusion of GBM related ABN AMRO businesses (£400.9 billion) and growth in derivative assets (mostly rates and currencies) accompanied by a corresponding increase in derivative liabilities. The derivatives increase was a result of the strong growth in client-driven interest rate and currency trading activities in a more volatile market environment. Risk-weighted assets increased by 39%, driven by the inclusion of £39.0 billion of risk-weighted assets from GBM related ABN AMRO businesses and careful risk and capital management.

Global Markets – Global Transaction Services

	2008	2007	2006
	£m	£m	£m
Net interest income	909	595	449
Non-interest income	1,563	1,183	1,081
Total income	2,472	1,778	1,530
Direct expenses			
– staff costs	392	271	231
– other	202	178	109
	594	449	340
Impairment	60	14	4
Contribution	1,818	1,315	1,186

	£bn	£bn	£bn
Total third party assets	24.0	22.5	7.4
Loans and advances	18.6	18.7	6.6
Customer deposits	60.9	56.8	34.2

2008 compared with 2007
Global Transaction Services (GTS) grew income by 39% to £2,472 million and contribution by 38% to £1,818 million for the full year 2008, reflecting the strength and enhanced international capability of its cash management, trade finance and merchant acquiring platforms. The income growth rate was maintained in the second half of the year, despite difficult market conditions. The key driver of this growth has been the acquisition of the ABN AMRO business with the historic RBS business contributing year on year income growth of 5%.

Growth was driven by a strong performance in cash management, in particular international cash management in ABN AMRO. Steady growth was achieved in the RBS UK and US domestic markets. Average customer deposits were higher mitigating the impact of lower interest rates. International overdrafts have been re-priced, reflecting the increased cost of funds and higher risk premia during the second half of the year. Fee income from payment transactions increased strongly, particularly in the US and internationally. The division was successful throughout the year in winning new international cash management mandates from existing RBS Group clients due to the strength of the international payments platform and network.

Trade finance made good progress, with income continuing to grow strongly as the ABN AMRO platform enabled GTS to substantially improve its penetration into the Asia-Pacific market, and has expanded its supply chain finance activities with an enhanced product suite. Margins improved throughout the year reflecting the additional risk premium in the market conditions.

Merchant services and commercial cards delivered growth despite the worsening economic climate. Acquiring transaction volumes were up in the year driven by good growth in online volumes, but weaker consumer confidence in the latter part of the year meant that average transaction values decreased, slowing income growth. Commercial cards income saw strong growth for the full year, driven by higher interchange income particularly in the small and middle markets.

Direct expenses rose by 32% to £594 million, reflecting the full year costs of the ABN AMRO business, historic RBS business costs increased by 10%. The full year cost growth reflected investment in staffing and infrastructure to support GTS's development.

Impairment losses were £60 million, up from £14 million in 2007, reflecting in particular the downturn in the global economy and some growth in defaults amongst mid-corporates and SMEs.

2007 compared with 2006

Global Transaction Services grew income by 16% to £1,778 million and contribution by 11% to £1,315 million, driven by growth in the Merchant Services business, combined with the enhanced international cash management and trade platforms introduced through the ABN AMRO acquisition.

Revenue growth was evident across all product lines. Cash management growth was the result of increased deposit balances combined with payment fee growth initiatives. Merchant services and commercial cards delivered a 6% increase in income with particularly good growth in the international businesses. This growth has been driven by increased volumes across both debit and credit card transactions.

The Trade finance business benefits materially from the product suite introduced through the ABN AMRO acquisition through improved international capabilities and a global reach. Margins in this business have also begun to see the benefit of improved pricing reflecting country risk premiums.

Direct expenses rose by 32% to £449 million in comparison with 2006, primarily reflecting investment to expand the business. This includes the acquisition of ABN AMRO which incorporates costs directly related to the GTS business.

Impairment losses were £14 million compared with £4 million in 2006.

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Regional Markets – UK Retail & Commercial Banking

	2008 £m	2007 £m	2006 £m
Net interest income	6,999	6,602	6,350
Net fees and commissions – banking	2,919	3,054	2,896
Other non-interest income	1,080	1,450	1,327
Non-interest income	3,999	4,504	4,223
Total income	10,998	11,106	10,573
Direct expenses			
– staff costs	1,978	1,919	1,788
– other	1,193	1,076	1,082
	3,171	2,995	2,870
Insurance net claims	184	518	488
Impairment	1,964	1,368	1,497
Contribution	5,679	6,225	5,718

	£bn	£bn	£bn
Total banking assets	249.4	232.8	202.4
Loans and advances to customers – gross			
– UK Retail Banking	117.5	111.0	107.4
– UK Corporate & Commercial Banking	110.4	99.3	86.1
– UK Wealth	10.1	8.4	7.2
Customer deposits*	186.1	189.4	179.7
Investment management assets – excluding deposits	22.5	25.8	34.5
Non-performing loans	7.9	5.5	5.1

* excluding bancassurance

UK Retail and Commercial Banking retains an extremely strong franchise and represents the core of the RBS Group. However, the external environment over the next few years will present significant challenges with pressure on income as a result of very low interest rates, lower fee income, and impairment costs likely to increase further.

The business plans to respond to this environment through reducing costs and increasing productivity by investing in online service channels, automation of activities and re-design of end-to-end processes. The business will tailor the cost of service for different client segments more closely to their value generation.

Wealth management remains a strong growth opportunity and the business plans to pursue a more consolidated approach to the market through more co-ordination across the multiple brands with which it currently faces the market, whilst investing in additional Relationship Managers and platform functionality.

The division will pursue above market growth in customer deposits to improve its funding contribution to the Group, and will diversify its customer lending, reducing its exposure to commercial property.

Regional Markets – UK Retail & Commercial Banking
UK Retail Banking

	2008 £m	2007 £m	2006 £m
Net interest income	4,390	4,172	4,099
Net fees and commissions – banking	2,219	2,375	2,297
Other non-interest income	369	765	731
Non-interest income	2,588	3,140	3,028
Total income	6,978	7,312	7,127
Direct expenses			
– staff costs	1,258	1,266	1,203
– other	574	545	552
	1,832	1,811	1,755
Insurance net claims	184	518	488
Impairment	1,281	1,184	1,307
Contribution	3,681	3,799	3,577

	£bn	£bn	£bn
Loans and advances to customers – gross			
– mortgages	74.9	67.4	65.3
– personal	16.2	17.1	17.1
– cards	6.4	7.8	8.1
– business	20.0	18.7	16.9
Customer deposits*	95.9	96.1	86.8
Investment management assets – excluding deposits	5.7	7.0	6.7
Non-performing loans	4.8	4.3	4.4

* customer deposits exclude bancassurance

2008 compared with 2007
Despite an economic environment which became markedly weaker in the second half of the year, UK Retail Banking, which includes both personal and small business banking, held direct costs in line with 2007 while total income decreased 5% to £6,978 million. However the deterioration in the macroeconomic environment resulted in an 8% increase in impairment losses. Consequently, contribution decreased 3%, £118 million, to £3,681 million. In the personal segment, RBS retained top position and NatWest was again joint second for customer satisfaction amongst main high street banks. The business segment has continued to grow, maintaining market leadership with a share of 26%, alongside 23% of the start-up market. UK Retail continues to maintain availability of lending while managing risk exposure and focusing on supporting customers through a difficult economic environment.

Net interest income increased 5% to £4,390 million as a result of strong balance sheet growth. Net interest income performance in the personal segment was strong, up 7%, as a result of good volume growth coupled with improving new lending margins. The small business sector has seen more pressure on asset margins, from increased funding costs, which has restricted net interest income growth to 4%. Average loans and advances to customers increased 7%

and average deposits were up 6% with personal savings growing 9% and small business deposits growing 3%. At year end deposit balances were in line with 2007 levels, reflecting increasing competitive pressure in a slowing market. Net interest margin reduced from 3.92% to 3.85%, reflecting increased funding and liquidity costs.

UK Retail mortgage balances grew 11% despite more muted demand in the second half, and net mortgage lending market share increased to 19% (2007 – 2%). Small business lending grew 7% despite a significant contraction in demand. Personal unsecured lending slowed, however, particularly in the second half of the year. Further, the sale of Tesco Personal Finance (TPF) reduced personal unsecured balances at 31 December 2008 by £1.9 billion, though income of £285 million from TPF was included up to the date of the sale completion on 19 December.

Non-interest income declined 18% to £2,588 million. Bancassurance sales grew 3% to £353 million annual premium equivalent in the year, however the negative performance of debt and equity markets reduced investment income by £48 million. Excluding this, underlying non-interest income declined 6% reflecting reduced demand for unsecured lending and lower sales of payment protection insurance.

Direct expenses increased 1% to £1,832 million. Direct staff costs reduced 1% reflecting increased efficiency. Other direct costs rose by 5% as a result of increased investment in selected business lines.

During 2008 the division almost doubled the number of branches open on a Saturday and introduced 1,000 MoneySense advisers into branches to provide impartial advice to customers on managing their money.

Impairment losses increased 8% to £1,281 million, with an increase in small business delinquencies and personal impairments reflecting the changed economic environment, particularly in the second half. In the small business segment impairments increased to £158 million (2007 – £80 million). In the personal segment the increase in impairments has been more modest, with mortgage impairment charges at £33 million (2007 – £21 million) on a total book of £74.9 billion, while unsecured personal lending impairments remained level with 2007 at £1,091 million (2007 – £1,084 million). Higher Loan-to-Value ratio mortgages have been restricted and affordability criteria tightened. The average LTV for new business was 67% (2007 – 62%). Repossessions represented 0.06% of outstanding mortgage balances at 31 December 2008, compared with a Council of Mortgage Lenders' average at December 2008 of 0.21%.

Risk weighted assets totalled £63.8 billion at year end, a fall of 3% from 1 January 2008. The upward pressure from procyclicality, especially on the mortgage book, and book growth was offset by the disposal of TPF and improvements in Basel II methodologies.

2007 compared with 2006

UK Retail achieved strong results in 2007, increasing contribution by 6% to £3,799 million as a result of good income growth in both consumer and business banking combined with tight cost control and a reduction in impairment losses. Total income grew by 3% to £7,312 million, while income net of insurance claims grew by 2% to £6,794 million.

We have accelerated the expansion of our consumer banking franchise, opening more than 975,000 new personal current accounts in 2007 and maintaining the Group's joint number one position in the current account market. RBS and NatWest continue to lead the other major high street banks in Great Britain for customer satisfaction. We continue to focus on sales through the branch channel, and by adding more customer advisers in our branches have achieved a significant uplift in volumes.

Bancassurance continued its excellent progress with sales growth of 28% to £342 million annual premium equivalent, representing a doubling of 2005 sales. We invested further in our sales force, ending the year with more than 1,000 financial planning managers.

In business banking we strengthened our management team and improved operational processes, producing good results. During 2007 we placed an additional 500 business managers back in branches, launched additional products to support the start-up market, and added new roles supporting ethnic minorities, women in business and community banking.

In our cards and direct finance business, we have maintained our focus on credit card sales through the branch channel, where new business sales were up 47% on 2006, while continuing to take a cautious view on direct sales.

Savings balance growth was helped by good sales of new accounts to branch customers, with NatWest opening more than 1 million new savings accounts.

Mortgage activity focused on branch channels, where net lending was 14% higher than in the previous year. We also took advantage of improved margins in the intermediary segment in the latter part of the year to improve volumes. Direct loan balances declined over the year as we maintained our strategy of focussing unsecured personal lending on profitability rather than volume, although we continued to grow lending through the branch channel. After a decline in credit card balances in the first half of the year we improved recruitment and retention in the second half.

Net interest income increased by 2% to £4,172 million, with strong growth in deposits helping to mitigate the impact of lower unsecured lending volumes and lower average card balances. Net interest margin declined modestly, in line with previous guidance, with savings margins consistent with 2006, despite increased competition for deposits.

Non-interest income was £3,140 million, 4% ahead of 2006, with strong growth in investment income offset by lower levels of direct lending and reduced instances of current account fees.

Direct expenses rose by 3% to £1,811 million, driven by increased investment in customer-facing staff in branches and in our bancassurance and investment businesses. Other costs reduced by 1% to £545 million.

Impairment losses decreased by 9% to £1,184 million, reflecting the improvement in arrears trends on both credit cards and unsecured personal loans. Mortgage arrears remained very low, and we have maintained conservative lending criteria – the average loan-to-value ratio of UK Retail's mortgages was 46% overall and 63% on new mortgages written in 2007, and this improved as the year progressed. Small business credit quality remained good.

Regional Markets – UK Retail & Commercial Banking
UK Corporate & Commercial Banking

	2008	2007	2006
	£m	£m	£m
Net interest income	2,039	1,924	1,807
Net fees and commissions	450	425	385
Other non-interest income	672	658	569
Non-interest income	1,122	1,083	954
Total income	3,161	3,007	2,761
Direct expenses			
– staff costs	486	431	381
– other	529	467	457
	1,015	898	838
Impairment	671	180	188
Contribution	1,475	1,929	1,735
	£bn	£bn	£bn
Loans and advances to customers – gross	110.4	99.3	86.1
Customer deposits	64.3	66.2	71.0
Non-performing loans	3.0	1.2	0.7

2008 compared with 2007
UK Corporate & Commercial Banking experienced a solid performance in the first half of 2008, with the second half of 2008 being impacted by the marked deterioration in economic conditions. Total income increased 5% to £3,161 million. However, growth in impairments, especially in the second half of the year, resulted in a 24% fall in contribution to £1,475 million.

Net interest income increased 6% to £2,039 million. Average loans and advances were 18% higher than 2007, reflecting the Group’s continuing support for the UK economy. New business margins widened in the second half to reflect increasing risk premia, however, higher funding costs on the back book suppressed growth in net interest income.

Non interest income increased 4% to £1,122 million. 2007 benefited from the profit on disposal of the Securities Services Group business. This strong performance reflects increased sales of interest rate and currency risk management products.

Direct expenses increased 13% to £1,015 million, reflecting a 26% rise in operating lease depreciation to £401 million, due to higher volumes as well as additional provisions of £54 million for lower residual values in the Lombard vehicle leasing business. Direct expenses, excluding operating lease depreciation, increased by 6% to £614 million with cost growth reflecting the recruitment of additional relationship managers in 2007.

Impairment losses totalled £671 million, a sharp increase from the historically low levels seen in 2007. 48% of the charge related to house builder and property development companies. Losses were concentrated in the smaller end of the corporate sector, although a number of specific exposures in the larger corporate sector have also impacted the charge. The commercial businesses charge was £368 million (2007 – £100 million) and the corporate business charge was £303 million (2007 – £80 million).

The performance of our commercial property book remains under close watch. Average LTVs in the UK portfolio is 68% and less than 5% of the portfolio has LTVs greater than 85%.

RWA growth has been constrained by improvements in Basel II methodologies and active risk management, which have offset growth in the underlying balance sheet and the impacts of procyclicality.

2007 compared with 2006
UK Corporate & Commercial Banking had another successful year of profitable growth, building further on our market-leading position and achieving significant improvements in customer satisfaction. Total income rose by 9% to £3,007 million and contribution by 11% to £1,929 million.

There has been good growth in customer volumes, with average loans and advances up 15% and average deposits up 12%. Net interest income increased by 6% to £1,924 million as net interest margin narrowed slightly from the prior year. In recent months we have seen firmer margins in some areas.

Non-interest income rose by 14% to £1,083 million, as a result of growth in fees and continued progress in the distribution of trade and invoice finance products as well as of interest rate and foreign exchange products.

Direct expenses increased by 7% at £898 million due to investment targeted towards improving customer service. Around 600 new front line roles were created and major new functionality was added to the Bankline electronic banking platform. These initiatives have contributed to strongly favourable customer satisfaction scores in 2007.

Impairment losses totalled £180 million, 4% lower than in 2006, reflecting the strong quality of the portfolio. Corporate credit metrics remained stable.

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Regional Markets – UK Retail & Commercial Banking
UK Wealth

	2008 £m	2007 £m	2006 £m
Net interest income	570	506	444
Net fees and commissions	250	254	214
Other non-interest income	39	27	27
Non-interest income	289	281	241
Total income	859	787	685
Direct expenses			
– staff costs	234	222	204
– other	90	64	73
	324	286	277
Impairment	12	4	2
Contribution	523	497	406

	£bn	£bn	£bn
Loans and advances to customers – gross			
– mortgages	5.2	4.2	3.8
– personal	3.7	3.0	2.5
– other	1.2	1.2	0.9
Customer deposits	25.9	27.1	21.9
Investment management assets – excluding deposits	16.8	18.8	15.3
Non-performing loans	0.1	—	—

2008 compared with 2007
UK Wealth delivered robust growth, with total income increasing by 9% to £859 million and contribution increasing by 5% to £523 million.

UK Wealth generates earnings from both private banking and investment services, and this has enabled the division to maintain strong organic growth, despite the deterioration in global market conditions. Coutts & Co. performed particularly well, with contribution up by 15%.

Average loans and advances to customers rose by 17% and average customer deposits by 11%, underpinning a 13% rise in net interest income to £570 million.

Non interest income grew by 3% to £289 million as higher fee income was offset by lower investment income. Although average assets under management were 4% higher than in 2007, lower stock market levels in the latter part of the year reduced assets under management by 11% to £16.8 billion.

Direct expenses rose by 13% to £324 million partly due to increased headcount and higher deposit protection scheme contributions.

Impairments rose from £4 million in 2007 to £12 million and represented approximately 0.1% of the total UK lending book.

2007 compared with 2006

Wealth Management's offering of private banking and investment services continued to deliver very strong growth in income, up 15% in 2007 to £787 million. Contribution grew by 22% to £497 million.

We have continued Coutts & Co's UK regional expansion programme, and this has helped us to grow customer numbers by 7% and income by 22%.

Growth in banking volumes contributed to a 14% rise in net interest income to £506 million. Average loans and advances to customers rose by 16% and average deposits by 22%.

Non-interest income grew by 17% to £281 million, reflecting higher investment management fees and new product sales, including new investment vehicles specialising in private equity and natural resources, as well as continued growth in underlying new business volumes. Assets under management rose to £18.8 billion at 31 December 2007, up 23% from a year earlier.

Direct expenses increased by 3% to £286 million, reflecting continued investment in the UK.

Regional Markets – US Retail & Commercial Banking

	2008	2007	2006	2008	2007	2006
	£m	£m	£m	$m	$m	$m
Net interest income	2,106	1,935	2,041	3,902	3,872	3,764
Non-interest income	904	846	949	1,676	1,692	1,747
Total income	3,010	2,781	2,990	5,578	5,564	5,511
Direct expenses						
– staff costs	675	598	664	1,250	1,197	1,225
– other	411	364	402	762	728	743
	1,086	962	1,066	2,012	1,925	1,968
Impairment – core	722	177	180	1,337	351	332
Impairment – SBO	319	163	-	592	329	-
Contribution	883	1,479	1,744	1,637	2,959	3,211
	£bn	£bn	£bn	US$bn	US$bn	US$bn
Total assets	103.9	79.6	82.1	151.8	159.2	161.3
Loans and advances to customers – gross						
– mortgages	10.7	9.5	9.5	15.7	19.1	18.6
– home equity	23.8	17.9	17.6	34.8	35.9	34.5
– other consumer	14.6	10.8	11.7	21.3	21.6	23.1
– corporate and commercial	28.2	18.8	16.7	41.2	37.6	32.7
Customer deposits	64.6	52.8	51.5	94.3	105.8	101.1
Non-performing loans	0.8	0.3	0.2	1.1	0.6	0.3
Average exchange rate – US$/£				1.853	2.001	1.844
Spot exchange rate – US$/£				1.460	2.004	1.965

2008 compared with 2007

US Retail & Commercial Banking increased income by 8% to £3,010 million, primarily as a result of movements in exchange rates, but experienced a sharp increase in impairment losses as economic conditions progressively worsened over the course of the year. As a result, contribution declined to £883 million, down 40%. In dollar terms, total income was held steady at $5,578 million while contribution declined by 45% to $1,637 million.

Total income of £3,010 million increased by 8%, with 20% growth in commercial banking to £664 million and a 5% growth in retail banking income to £2,346 million. In dollar terms, total income of $5,578 million was essentially unchanged, with 11% growth in commercial banking to $1,231 million offsetting a 2% decline in retail banking income to $4,347 million. Both segments were affected by the deterioration in credit conditions, with retail contribution down 54% to £499 million and commercial contribution flat at £384 million. In dollar terms, retail contribution was was down 58% to $926 million and commercial contribution was down 7% to $711 million.

Overall, net interest income grew modestly, offset by a small decline in non-interest income. Average loans and advances to retail customers decreased as a result of the slowing economy and tighter underwriting standards, but this decline was offset by continued strong growth in corporate and commercial lending. Core customer deposits declined by 5% and the division further reduced its reliance on brokered deposits by 80%, leading to an overall decline of 11% in total customer deposits. Net interest margin was held steady at 2.73%, reflecting widening asset margins and management of savings rates in a competitive deposit market.

Direct expenses increased by 13% to £1,086 million, reflecting increased costs from the expansion of the commercial banking relationship management teams, write-downs on mortgage servicing rights, and higher costs related to loan work-out and collection activity together with movements in exchange rates. In dollar terms, direct expenses increased by 5% to $2,012 million.

Credit conditions worsened significantly over the course of the year as the housing market continued to deteriorate and unemployment rose, exacerbating already challenging conditions. Impairment losses totalled £1,041 million, up from £340 million in 2007 reflecting the deterioration in economic conditions. In dollar terms, impairment losses totalled $1,929 million, up 184% from 2007.

In the core US Retail & Commercial portfolio, 2008 impairment losses totalled £722 million ($1,337 million), with a marked increase in the second half. Consumer non-performing loans represented 0.37% of core home equity balances and 1.20% of residential mortgage balances. While there has been a decline in some customers' credit scores in line with weakening economic conditions, refreshed weighted average FICO scores for consumer real estate-secured lending at 31 December 2008 was approximately 740 with a weighted average LTV of 63%. Stress has emerged in all consumer segments during the second half of the year, with increased delinquency in core home equity (up 10bps to 0.86%), and auto (up 94bps to 2.78%). US Retail & Commercial does not originate negative amortization mortgages or option adjustable rate mortgages. Closing provision balances for the core portfolio were £892 million ($1,303 million) compared with £388 million ($777 million) at the end of 2007.

Credit quality has continued to deteriorate sharply in the externally sourced home equity portfolio (the Serviced By Others (SBO) portfolio). On a constant currency basis this portfolio, now managed by a separate work-out group and in run-off, has been reduced by £1.0 billion over the last year to £4.9 billion and $1.5 billion in dollar terms to $7.1 billion at 31 December 2008. Non-performing SBO loans represent 2.66% of SBO balances. Impairment losses in relation to the SBO portfolio totalled £319 million ($592 million) for 2008, with £155 million ($268 million) incurred in the second half of 2008 compared with £164 million ($324 million) in the first half. Closing SBO provision balances amounted to £325 million ($474 million) at 31 December 2008, up from £208 million ($413 million) at 30 June 2008, providing a coverage ratio of 2.5 times non-performing loans.

The overall commercial loan portfolio has begun to show signs of stress, with a marked deterioration in the commercial real estate book. Impairments in the commercial and industrial portfolio, including lease financing, totalled $212 million, or 0.74% of balances. Total impairments within the commercial real estate portfolio were $177 million, or 1.63% of balances.

The US business has continued to evaluate opportunities to optimise capital allocation by exiting or reducing exposure to lower growth or sub-scale segments. In the fourth quarter, 18 rural branches in the Adirondacks region were sold to Community Bank System. An agreement has also been announced to sell the Indiana retail branch banking network, consisting of 65 branches, and the business banking and regional banking activities, to Old National Bank.

2007 compared with 2006

Against the background of weaker housing and credit market conditions, the US Retail & Commercial Banking division demonstrated resilience in 2007, with a particularly good performance in corporate and commercial banking. Despite modest growth in net interest margins and strong fee growth in several products, total income fell by 7% to £2,781 million due mainly to the weak dollar exchange rate but, in dollar terms, total income was flat at $5,564 million. Tight cost control helped limit the fall in contribution. However, impairment losses increased from 0.31% of loans and advances to 0.60%, resulting in a decrease in contribution of 15% to £1,479 million, or 8% to $2,959 million in dollar terms.

Net interest income fell by 5% to £1,935 million due mainly to the unfavourable dollar exchange rate. In dollar terms, net interest income rose by 3% to $3,872 million. Average loans and advances to customers increased by 4%, with strong growth in corporate and commercial lending, up 13%, with close attention being paid to our risk appetite in light of prevailing market conditions. Average customer deposits were flat and deposit margins narrowed as a result of deposit pricing competition and continued migration from low-cost checking accounts and liquid savings to higher-cost products. Notwithstanding this migration, US Retail & Commercial Banking net interest margin increased slightly to 2.74% in 2007, compared with 2.66% in 2006, thanks in part to improved lending spreads in the latter part of the year.

Non-interest income fell by 11% to £846 million. In dollar terms, non-interest income fell by 3% to $1,692 million. Business and corporate fees rose strongly, with good results especially in foreign exchange and interest rate derivatives, driven by increasing cooperation with RBS Global Markets. Good progress was also made in credit card issuing, where we increased our customer base by 20%.

In response to more difficult market conditions the division intensified cost discipline, with a reduction in headcount helping to reduce direct expenses by 10%. In dollar terms, the fall in direct expenses was just 2%, despite enhancements to infrastructure and processes as well as continued investment in growth opportunities including mid-corporate banking, and contactless debit cards.

Rising losses and increased provisions lifted impairment costs from £180 million in 2006 to £340 million in 2007. In dollar terms, impairment losses rose from $332 million in 2006 to $680 million in 2007. Against a background of weaker economic activity the US Retail & Commercial Banking division portfolio is performing well, although we have experienced a reversion from the very low levels of impairment seen in recent years, reflecting both the planned expansion of our commercial loan book and the impact of a softer housing market. There has also been an increase in reserving. The average FICO scores on our consumer portfolios, including home equity lines of credit, remain in excess of 700, with 97% of lending secured. Average loan-to-value ratios at the end of 2007 were 58% on our residential mortgage book and 74% on our home equity book.

Regional Markets – Europe & Middle East Retail & Commercial Banking

	2008	2007	2006
	£m	£m	£m
Net interest income	1,087	958	824
Net fees and commissions	320	219	201
Other non-interest income	111	169	119
Non-interest income	431	388	320
Total income	1,518	1,346	1,144
Direct expenses			
– staff costs	404	307	251
– other	159	152	114
	563	459	365
Impairment	526	118	104
Contribution	429	769	675
	£bn	£bn	£bn
Total assets	66.4	56.1	44.5
Loans and advances to customers – gross			
– mortgages	24.6	18.3	14.9
– corporate	33.4	25.3	19.6
– other	3.7	4.2	3.6
Customer deposits	25.0	22.3	18.1
Non-performing loans	3.3	0.7	0.5

2008 compared with 2007

The significant deterioration in global and local market conditions has impacted the main Europe & Middle East markets, with contribution falling to £429 million, 44% lower than in 2007. The main driver of this reduction has been an increase of £408 million in impairments, albeit from a low base, reflecting deterioration in credit quality particularly in the property and construction sectors, as economic conditions have slowed.

Total income was up £172 million, 13% at £1,518 million benefitting from the full year of the ABN AMRO businesses and movements in exchange rates. Direct expenses were up 23% to £563 million. Impairment losses rose sharply to £526 million from £118 million reflecting the economic environment.

In sterling terms the results have been materially affected by the movement in the euro exchange rate and references to percentage movement in the following analysis are in constant currency terms.

Within the core business of the region, Ulster Bank, contribution fell to £117 million. Total income decreased by 2% to £1,269 million; net interest income increased by 1%, with average loans and advances to customers up 12% in the year. The benefit from growth in lending, particularly in the first half of the year has been offset by increased funding costs associated with the wholesale funding market dislocation. Other income was 12% lower than in 2007, reflecting a slowdown in particular in the bancassurance and wealth businesses.

Average mortgage balances in Ulster Bank were 11% higher than 2007. New mortgage volumes in the second half of the year were significantly lower than in the first six months, although levels of redemptions have also fallen.

Average deposit balances in Ulster Bank were largely flat year-on-year reflecting the highly competitive market for resources in Ireland in 2008. Deposit flows were strong in the latter part of the year and into the early months of 2009. During 2008, we opened 119,000 new current accounts driven by particularly successful current account switcher and student campaigns.

Direct expenses rose by 8% to £432 million, reflecting the full year impact of the now completed investment programme in Ulster Bank's footprint and operations. Cost growth in the second half of 2008 was significantly lower, reflecting disciplined management of the cost base.

Impairment losses in Ulster Bank rose to £394 million, reflecting the impact on credit quality of the slowdown in the Irish economy, with the final quarter showing the most notable decline in both activity and sentiment. This was reflected in a significantly increased flow of cases into the problem debt management process.

In January 2009, Ulster Bank announced its intention to adopt a single brand strategy under the Ulster Bank brand. This will see the merger of the operations of Ulster Bank and First Active in the Republic of Ireland ("RI") by the end of 2009. This action is being taken to strengthen the Ulster Bank Group franchise by positioning it to deal with the prevailing local and global market conditions. A number of cost management initiatives have also commenced across the business.

Ulster Bank has launched a series of initiatives to support its customers in this difficult economic period. We announced in February 2009 that we will be making significant funds available to the Northern Ireland ("NI") SME market. A similar announcement will be made in the coming weeks regarding the RI SME market. Ulster Bank has also indicated that it is adopting the RBS Group pledge regarding certainty of overdraft limits for this sector.

The Momentum and Secure Step mortgages have been launched in NI and RI respectively to support First Time Buyers and the Bank has confirmed its pledge of a six-month moratorium to mortgage customers facing potential repossession. In support of our retail customers across the island of Ireland the Group's MoneySense programme is being rolled out, with trained advisers being introduced to all Ulster Bank branches.

Outside Ireland, Europe & Middle East Retail & Commercial Banking continued to trade satisfactorily, although our markets in the United Arab Emirates, Romania and Kazakhstan have also experienced a marked slowdown in the past year. In UAE, we are a market leader in credit cards with over 430,000 cards in issue.

The sale of the European Consumer Finance business to Santander was completed on 1 July 2008, while the Imagine business in Spain was sold to Bank of America in the second half of 2008. The former ABN AMRO retail business in Russia was also closed during the year.

2007 compared with 2006

Europe and Middle East Retail & Commercial Banking maintained its success in building its personal and corporate banking business, particularly in the island of Ireland, with total income rising by 18% to £1,346 million and contribution by 14% to £769 million. These results reflect solid sales growth across all activities, driven by an enhanced range of innovative products and an expanded distribution network.

Net interest income increased by 16% to £958 million, reflecting good growth in both loans and deposits. Average loans and advances to customers increased by 24%, with particular strength in business lending, with a 29% increase spread across a variety of industrial sectors. Our mortgage book also saw very good growth in 2007, in spite of the slowdown in the housing market, with average balances up 17%. We achieved particular success in attracting remortgagers with our Switcher package. We were also successful in the current account switching market, winning 100,000 new current account customers during the year. This, together with new product launches such as the eSavings Account and Reward Reserve savings accounts, contributed to a 18% increase in average customer deposits. Net interest margin tightened, reflecting more competitive market conditions and increased funding costs.

Non-interest income rose by 21% to £388 million, driven by strong performances in Global Markets and credit cards. We successfully launched our new wealth business in the course of the year.

Direct expenses increased by 26% to £459 million, as we continued our investment programme to support the future growth of the business. We continued to expand our branch and business centre footprint and recruited additional customer-facing staff, particularly in our Global Markets business.

Impairment losses have risen to £118 million, reflecting growth in lending as well as a slowdown in economic conditions which has affected commercial credit metrics.

Regional Markets – Asia Retail & Commercial Banking

	2008	2007	2006
	£m	£m	£m
Net interest income	379	123	52
Net fees and commissions	309	161	136
Other non-interest income	93	71	