

ROYAL BANK OF SCOTLAND GROUP PLC  
Form 6-K  
August 07, 2009

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

**Report of Foreign Private Issuer**

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

For the month of August 2009

Commission File Number: 001-10306

The Royal Bank of Scotland Group plc

RBS, Gogarburn, PO Box 1000  
Edinburgh EH12 1HQ

(Address of principal executive offices)

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

Form 20-F

Form 40-F

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

Yes

No

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

Interim Results  
for the half year ended  
30 June 2009

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**Appendix 1 Reconciliations of pro forma to statutory income statements and balance sheets**

**Appendix 2 Analysis by quarter**

**Appendix 3 Asset Protection Scheme**

**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', '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: the extent and nature of future developments in the credit markets, including the sub-prime market, and their impact on the financial industry in general and the Group in particular; the effect on the Group's capital of write downs in respect of credit market exposures; 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 G-7 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 announcement, and the Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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

## **Presentation of information**

### **Acquisition of ABN AMRO**

On 17 October 2007, RFS Holdings B.V. ('RFS Holdings'), a company jointly owned by The Royal Bank of Scotland Group plc ('RBS'), Fortis Bank Nederland (Holding) N.V. ('Fortis') and Banco Santander S.A. ('Santander') (together, the 'Consortium Members'), completed the acquisition of ABN AMRO Holding N.V. ('ABN AMRO').

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.

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

The separation of platforms shared between RBS and its Dutch state-owned partner has been completed and the Group is now on track, subject to legal process and regulatory approvals, for the legal separation of the constituent parts of

ABN AMRO by the end of the year. From that point RBS will cease to consolidate the Dutch state's interest in RBS Group statutory accounts.

### Pro forma results

Pro forma results have been prepared that include only those business units of ABN AMRO that will be retained by RBS. The financial review and divisional performance and discussion of risk and capital management in this Company Announcement focus on the pro forma results. The basis of preparation of the pro forma results is detailed on page 72.

### Statutory results

RFS Holdings is jointly owned by the Consortium Members. It is controlled by RBS and is therefore fully consolidated in its statutory financial statements. The interests of the State of the Netherlands and Santander in RFS Holdings are included in minority interests.

### Restatements

Divisional results for 2008 have been restated to reflect the Group's new organisational structure that includes a Non-Core division comprising individual assets, portfolios and lines of business that the Group intends to run off or dispose of. The Non-Core division is reported separately from the divisions which form the Core Group. In addition, separate reporting of Group Manufacturing and Centre results has changed and, with the exception of certain items of a one off nature, costs incurred are now allocated to the customer-facing divisions and included in the measurement of the returns which they generate. The changes do not affect the Group's results. Comparatives have been restated accordingly. Descriptions of business for the new divisions are set out on page 27.

The pro forma and statutory results for 2008 have been restated for the amendment to IFRS 2 'Share-based Payment'. This has resulted in an increase in staff costs amounting to £35 million for the first half of 2008 and £169 million for the full year 2008.

The pro forma and statutory results for the first half of 2008 have been restated for the finalisation of the ABN AMRO acquisition accounting.

### Results summary - pro forma

	First half	First half	Change	Full year
	2009	2008	%	2008
	£m	£m		£m
<b>Core</b>				
Total income (1)	<b>17,793</b>	14,192	25	24,437
Operating expenses (2)	<b>(7,745)</b>	(7,218)	7	(13,856)
Operating profit before impairment losses (3)	<b>8,471</b>	5,385	57	7,364
Impairment	<b>(2,177)</b>	(670)	-	(2,512)
Operating profit (3)	<b>6,294</b>	4,715	33	4,852
<b>Non-Core</b>				
Total income (1)	<b>(3,002)</b>	(2,541)	18	(3,838)
Operating expenses (2)	<b>(988)</b>	(1,175)	(16)	(2,332)

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Operating loss before impairment losses (3)	<b>(4,304)</b>	(4,054)	6	(6,870)
Impairment	<b>(5,344)</b>	(809)	-	(4,920)
Operating loss (3)	<b>(9,648)</b>	(4,863)	98	(11,790)

**Total**

Total income (1)	<b>14,791</b>	11,651	27	20,599
Operating expenses (2)	<b>(8,733)</b>	(8,393)	4	(16,188)
Operating profit before impairment losses (3)	<b>4,167</b>	1,331	-	494
Impairment	<b>(7,521)</b>	(1,479)	-	(7,432)
Operating loss (3)	<b>(3,354)</b>	(148)	-	(6,938)
Profit/(loss) before tax (4)	<b>15</b>	(726)	-	(8,296)
Loss attributable to ordinary shareholders	<b>(1,042)</b>	(827)	26	(24,306)

**Performance ratios**

Return on equity (5)	<b>(18.1%)</b>	(2.0%)	(1,610bp)	(13.9%)
Net interest margin	<b>1.69%</b>	2.07%	(38bp)	2.08%
Cost:income ratio (8)	<b>59.0%</b>	72.0%	(1,300bp)	78.6%
Adjusted cost:income ratio (9)	<b>67.7%</b>	86.3%	(1,860bp)	97.0%

	<b>30 June 2009</b>	31 December 2008	Change
<b>Capital and balance sheet (Pre-APS)</b>			
Total assets	<b>£1,644.4bn</b>	£2,218.7bn	(26%)
Funded balance sheet (10)	<b>£1,088.6bn</b>	£1,227.2bn	(11%)
Loan:deposit ratio	<b>144.5%</b>	152.4%	(790bp)
RWAs	<b>£547.3bn</b>	£577.8bn	(5%)
Total equity	<b>£57.8bn</b>	£64.3bn	(10%)
Core Tier 1 ratio	<b>6.4%</b>	5.9%	50bp
Tier 1 ratio	<b>9.0%</b>	9.9%	(90bp)
Tier 1 leverage ratio (6)	<b>21.7x</b>	21.2x	2%
Net tangible equity per share	<b>58.0p</b>	73.8p	(15.8p)
Tangible equity leverage ratio (7)	<b>3.0%</b>	2.4%	60bp

For definitions of the notes see page 26.

**First half 2009 update**

**Performance highlights**

*"This was a momentous half year for RBS. We gave a full and clear account of our vulnerabilities to the 'credit crunch'. We set out comprehensive restructuring plans, now with clear performance targets. And implementation is well under way, though uncertainties remain.*

*Our first half results, as we had clearly warned, are poor with a net attributable loss of £1,042 million. However, they highlight well our core business potential, the hard work of our people in difficult times, the strength of our customer franchises and the vulnerabilities and economic headwinds we grapple with."*

Stephen Hester, Group Chief Executive

**Pro-forma**

· **Group  
financial  
performance**

- o Group pre-tax profit\* of £15 million.
- o Gain of £3.8 billion on debt exchange.
- o Net attributable loss of £1,042 million, after minority interests and preference dividends.
- o Impairments rising across the Group to £7.5 billion.

· **Core  
Bank**

- o Core Bank recovery with operating profit of £6.3 billion.
- o Strong income growth to £17.8 billion, with GBM benefiting from favourable market conditions.
- o Resilient performance in Core retail and commercial banking pre-impairments, despite margin attrition from higher deposit and funding costs.
- o Cost saving programme delivers £0.6bn, with adjusted Group cost:income ratio improving.
- o Market positions sustained in chosen markets, with good growth in customer numbers.

· **Financial  
restructuring**

- o



Total assets reduced by £574 billion, or 26%, since December 2008.

- o New Non-Core Division begins run-off; £94 billion reduction in third party assets.
- o Non-Core run-off plan targets c.£230 billion reduction by 2013.
- o Core Tier 1 ratio improves to 6.4% - + >5% pro-forma for Asset Protection Scheme.†
- o APS key to RBS's short-term ability to withstand stressed scenarios, though important issues remain to be confirmed.
- o Loan:deposit ratio improved to 144% from 152% in December 2008.
- o Liquidity and funding positions steadily improving since December 2008.

\* Excluding write-down of goodwill. Operating loss before tax of £244 million on a statutory basis. See appendix 1 for a reconciliation between pro forma and statutory basis.

† See page 17 for conditionality

## Results summary - statutory

### Highlights

- Income up 58% to £21.8 billion.
- Pre-tax loss of £244 million.
- C o r e  
T i e r 1  
r a t i o  
7.0%

	<b>First half</b>	First half		Full year
	<b>2009</b>	2008	Change	2008
	<b>£m</b>	£m	%	£m
Total income	<b>21,841</b>	13,842	58	25,868
Operating expenses	<b>(11,891)</b>	(10,719)	11	(54,202)
Operating profit/(loss) before impairment losses	<b>7,816</b>	934	-	(32,764)
Impairment	<b>(8,060)</b>	(1,661)	-	(8,072)
Operating loss before tax	<b>(244)</b>	(727)	(66)	(40,836)
Loss attributable to ordinary shareholders	<b>(1,042)</b>	(827)	26	(24,306)

### Chief Executive's letter to shareholders

This has been a tumultuous half year for RBS, which started with our share price falling to 10 pence per share on full disclosure of the damage sustained by RBS from the "credit crunch" and our vulnerability to it. With this "call to action" as backdrop, we have devised and now set out restructuring plans and targets to rebuild RBS whilst serving customers well. We are putting those plans into action. At the same time we are sustaining our businesses and operating through unprecedented pressures, challenges and change. The "new RBS" will be a very different bank than before, in both what we do and the way we do it, and rightly so.

Let me be clear, I am optimistic for RBS's future. We can restore the Bank to standalone strength and viability. We will thereby rebuild attractive, sustainable shareholder value and, I believe, allow Government support to be recouped in full. But there will be no miracle cures. Our task is no less than one of the largest bank restructurings ever done, in the face of strong economic headwinds. Overall results may not substantially improve until 2011 and full recovery will take time. Along the way we will still need the Government support that gives us time and strength to restructure. We will repay that with results and responsible support to the communities who in turn are supporting us.

Given the agenda before us and the high levels of customer, shareholder and public interest, I attempt to set out herein, what we are doing, why and how we propose to be measured.

### Building the new RBS on strong foundations

We have a strong plan in place that I believe can get us to where we need to be by 2013. To achieve the goals of our different stakeholders we need to remake RBS as one of the world's most admired, valuable and stable universal banks powered by market-leading businesses in large customer-driven markets. We will target a sustainable 15% plus return on equity with an AA category risk profile and well capitalised balance sheet. The business mix should produce an attractive blend of profitability, stability and sustainable growth. Anchored in the UK and in retail and commercial banking, we will retain strong but more focused global capabilities in the areas required to serve our customers well.

We are not starting from scratch. The foundations of RBS derive from the rock of our customer franchises around the world. Our first half performance demonstrates this in the face of every possible contrary reason, with customer numbers steady or growing in each of our major businesses. This tells me that we provide services and products that matter to our customers. And that our people, despite all their own challenges and disappointments, are hard at work serving our customers well. Our new strategy will build on these important realities.

### Understanding what went wrong

While the banking crisis has many roots, its economic foundations lie in a long era of easy money. As a bank with deep exposures in economies which are structurally indebted, we were more exposed to the crisis than many. The balance between saving and borrowing remains out of step in many parts of our core markets, and it is the same with the banks, which generally mirror the economies they serve. The answer to our collective problem is not to go back to lending or borrowing too much.

That said, it would be a serious error to suggest that RBS merely reflected the macro-economic context in which it operated. RBS made mistakes and had vulnerabilities of its own doing. We set these out clearly in February and the plans we confirm today are designed to address each and every aspect.

### **Chief Executive's letter to shareholders**

#### **Strategy and Performance Targets**

Our strategy has three interlocking elements.

- **Financial  
Restructuring**

We plan to radically restructure RBS's balance sheet, reducing management stretch and risk exposures. We target a c.£500bn gross reduction in "funded" assets (which we are over halfway through). This will be achieved primarily through the run-down and sale of assets placed in our newly established Non-Core Division. This is a big and vital task. We have disclosed today for the first time the targeted profile of that asset run-off, with milestones along the way and subject to the important risk factors I identify later in this letter. The Non-Core Division also helps protect the Group's core customer-facing businesses by freeing up their management to focus on delivery for customers.

- **Core Business  
Restructuring**

As I have said, at the heart of RBS are inherently strong and valuable businesses driven by enduring customer franchises. Every one of these businesses can and must be made better. Along the way we will refocus on serving customers well, restructure to cure past vulnerabilities and retool to meet the changed market realities likely to prevail in future. This is also a major endeavour. Like every other business, major efficiency improvements are a survival necessity but so too is renewed investment to revitalise our customer proposition and service levels.

- **Cross Cutting Management and  
Cultural Change**

Throughout all we do, these binding disciplines will be implemented: Careful long-term strategic thinking over short-term opportunism. Empowerment of our people with corresponding accountability. Combining the "make it happen" drive for results with a new found (but enduring) humility, transparency and openness. A realisation that our

customers' health and our own are interdependent, and a fundamental change to risk sensitivity, with business growth focused on quality, achieved organically and facilitated but not driven by balance sheet and risk resources.

To show we are both serious and accountable, we set out clear targets today for our return to financial viability and the rebuild of sustainable shareholder value.

Measure	2008 Actual	2013 Targets
<b>Risk and Viability</b>		
Stand-alone Credit Rating (1)	BBB category	AA category
Core Tier 1 Capital Ratio	4%(2)	>8%
Loan:Deposit Ratio	156% (3)	c.100%
Wholesale funding reliance (4)	£343bn (5)	<£150bn
Liquidity reserves (6)	£90bn (7)	c.£150bn
<b>Shareholder value</b>		
Return on Equity (8)	(28%)	>15%
Cost/Income Ratio (C:I)	79%	<45% (9)
C:I Net of insurance claims	97%	<50% (9)

(1) Standard & Poors rating, ex HMG support (2) As at 1 January 2008 (3) As at October 2008 (4) Amount of unsecured wholesale funding under 1 year (£bn) (5) As at December 2008 (6) Eligible assets held for contingent liquidity purposes including cash, Government-issued securities and other securities eligible with central banks (7) As at December 2008 (8) After tax return on tangible equity normalised for APS in 2013 (9) Core Bank

#### Chief Executive's letter to shareholders (continued)

These targets are not forecasts. Events will ensure we either beat them or fall short. In particular the risks we flag herein remain real threats. But they are a serious statement of intent. Every Division has subsidiary targets we have also published today. And while 2013 seems a long way away, each year we intend to make measurable progress towards these goals.

#### First Half Results and Actions to date

Our first half results, as we had clearly warned, are poor with a net attributable loss of £1 billion. However, presented as they are now in alignment with the new strategy, they highlight well our core business potential, the hard work of our people in difficult times and the vulnerabilities and economic headwinds we grapple with.

Our Core Business Divisions reported an Operating Profit of £6.3 billion on revenues up 25% to £17.8 billion. This result was driven by a creditable rebound in GBM, our investment banking business, reversing the terrible losses of 2008, though this performance level is likely to weaken substantially in the second half. Nevertheless, the complementary balance to our retail and commercial banking businesses which were strong last year but now suffer the margin squeeze and rising credit costs of economic recession is helpful. However, across all our businesses, customers were served well, and steps taken to rebuild margins and efficiency ratios for future years. In fact, a strong start has been made to increasing efficiency, with £0.6 billion of savings so far, though these have been offset by

foreign exchange movements making clear that more is needed.

We took important steps to reduce risk, whilst still early days. Our total balance sheet is down from a £2,219 billion peak in 2008 to £1,644 billion. Our gross funded assets are down £350 billion in constant currency terms, from their peak. Our important loan-to-deposit ratio has improved by 8 percentage points since the end of 2008 to 144% and vital steps have been made to a more secure liquidity and funding profile.

RBS's vulnerabilities and the harsh recessionary conditions also show through clearly. Our Non-Core Division shows an Operating Loss of £9.6 billion. Across the Group, impairments rose 409% to £7.5 billion and are set to stay high for a while.

In addition to intense business activity, the strategy and cultural moves described above have been fundamental changes for RBS. We have also achieved comprehensive renewal of Board and management (outlined below), are pressing ahead with all the implementation plans and a range of targeted disposals. And have made further strides in financial and business disclosure, evidence of the open, investor friendly approach we mean to take.

### **Asset Protection Scheme (APS)**

The APS, agreed in principle with the UK Government (HMG) in February, has significant uncertainties though we still anticipate that it can be concluded in the autumn. APS remains essential to RBS to give us additional resilience during the time it will take to regain standalone strength. Without the combination of asset insurance and "B" share issuance, RBS would not pass the FSA-mandated stress tests and would be vulnerable to ratings downgrades and funding difficulties as a consequence.

### **Chief Executive's letter to shareholders (continued)**

Notwithstanding APS's importance, it is by no means "free". Our central case estimates suggest that the cost to HMG of APS will be broadly recouped through the substantial fees and tax give-ups to be paid by RBS, although other more positive and negative outcomes remain very real. Additionally, EU approval for the "state aid" given to RBS is uncertain as to both timing and outcome. RBS's massive restructuring programme provides a comprehensive and rigorous path back to standalone viability which the EU needs to review. Additionally it seems likely to require weakening of our core UK banking franchise, especially for business customers. Negotiations are ongoing here and we are very cognisant of the business disruption risks to customers and our ability to serve them, as well as to our own prospects of successful recovery.

The APS itself, while conceptually straightforward, has enormous operational complexity which is taking time to resolve. For example, HMG has requested regular reporting on up to one billion lines of data covering assets in the scheme and our own systems and data quality are not well designed for the APS purpose. The principal commercial aspects of the APS announced in February remain in place including coverage and pricing on the basis of asset evaluation as from 1 January, 2009. The overall economic impact of the APS, in conjunction with RBS's own extensive restructuring measures laid out herein, is expected to enable RBS to meet the FSA stress tests during its restructuring period. However, issues still outstanding include the final sign-off of assets to be covered, confirmation of the price of the coverage in the light of completed due diligence and state aid requirements and some detailed aspects of the structure of the scheme. Accordingly until these issues can be confirmed and state aid approval has been received care must be taken in assessing the complete economic impact on RBS of the APS. Discussion on these points continues and we will provide updates when we can. APS's merits will be more fully assessed at the time a general meeting is necessary for shareholder approval.

### **In the Limelight**

We are in the limelight - understandably but uncomfortably so.

Everyone at RBS is acutely aware of the fact that we are in a fortunate position to be able to restructure the Bank with the support of the UK Government behind us. This support exists because of our central position in the fabric of society and the economy, both in the UK and internationally. With that come responsibilities large and small to our shareholders, customers, staff and the communities where we do business. Our mission is to fulfil them all and remake RBS as a premier financial institution by serving our customers better. This will enable us to restore our financial strength, allowing the UK Government to sell down its investment in us, at a profit.

And it would be wrong not to acknowledge the effectiveness of UKFI - our new majority shareholder - in treading a constructive and commercial but demanding and engaged path. "Fidelity with nuclear weapons" they are dubbed in the press - an apposite if colourful description.

However, we especially, but all banks too, have become regrettably high profile. We sometimes feel as if commentators variously want us to go back to over-lending, to operate on a 'not-for-profit' basis, to never entertain a client and to offer employment conditions that deter the best and brightest. Oh yes, and at the same time to pull off a recovery enabling taxpayers to recoup the support given. Thankfully, our serious engagement with Government, Central Banks, Regulators, customers and other political parties is generally more balanced and insightful.

#### **Chief Executive's letter to shareholders (continued)**

##### **Fulfilling lending commitments**

One of the fundamental changes in the wider economic environment is a shift in power from borrowers to savers following the end of the credit boom. This means banks' borrowing costs are often much higher than reference rates like the Bank of England Base Rate. We need to charge borrowers higher margins in return to simply do no more than stay even, though customers' absolute cost of borrowing is generally much reduced. Borrowers have found this a difficult transition and there is understandably much public discourse on the issue. But today's results make crystal clear, that RBS is making less profit from banking customers than before, not more, and currently not enough to return to the financial stability that is necessary.

Against a recessionary backdrop we face a challenge of finding enough credit worthy borrowers wishing to take on new debt when their own business prospects and customer demand is weaker. This is, of course, normal in a recession as most prudent households and companies aim to reduce debt levels. And indeed, without increased saving overall, soundly based economic recovery will be difficult.

Our UK lending performance in the first half of the year reflects these factors and is detailed fully on page 20 herein. I am pleased to report that we have made new loans totalling £36 billion to UK homeowners and businesses in the first half. This includes a healthy proportion of mortgage loans to first time buyers and 100,000 loans to businesses, representing an 85% acceptance rate in the SME sector.

However, customers have also been actively paying down existing debt and have not been increasing overdraft borrowing. And despite our lending successes, loan applications by small businesses in the half were 37% down on the prior year. As a result, while we are on track to grow net mortgage lending by £9 billion as planned, achieving the business lending targets remains challenging.

But we are only four months into the period of our lending commitments. We will continue doing everything we can to make loans available to creditworthy customers at fair rates. Let there be no doubt we want to support our customers and are ready, willing and able to increase lending in line with our undertakings if the demand is there.

## **Our People**

At the heart of all we need to do lie our people. Those with accountability for past mistakes have gone. Looking forward, however, if we are to change, recover and to serve customers well it will be because we can retain, attract and motivate good people - for whom there are always alternative jobs.

Our people have also suffered - financially, in their job security, dented pride in RBS and from relentless media hostility and controversy. I would like to be clear. They are doing a great job overall. Without their efforts, enthusiasm, dedication and resilience we would surely fail in our recovery mission.

We have needed to make important changes. We are doing this swiftly to minimise uncertainty.

### **Chief Executive's letter to shareholders** (continued)

People represent half of our operating costs so it is deeply regrettable but inevitable that job losses are happening. We will continue to put communication with staff and their representatives first and be as transparent and open in the process as we can be. We believe this approach is the most appropriate for the position we are in and intend to stick to it. I am pleased that fewer than 25% of the job cuts we have made to date in our UK banking businesses have resulted in compulsory redundancy. We want to keep this figure as low as we can.

Our new Chairman, Philip Hampton, has made substantial progress in restructuring our Board to be smaller, more focused and with a new composition. Since October 2008, 12 members have left and five have joined. Today I am also very pleased to welcome our new Finance Director, Bruce Van Saun. His recruitment completes our new Executive Committee line up, all 9 members of which are new to role over the last 18 months.

One of the most difficult issues we face is balancing our need to attract, retain and reward talented staff whilst making reforms to pay in a way that recognises the reality of the position we are in and how society views our sector. For right or for wrong, in all walks of life, the pay levels people are offered for doing similar jobs elsewhere are a key benchmark. We know to our cost, having suffered significant resignations of valuable staff members this year, that we cannot ignore competitor pay practices or we will fail as a business. However, we can and have led in the way that we structure our rewards to staff and we hope that the rest of the industry follows this lead. Unusually among banks, bonuses across the RBS Group where merited are now subject to deferral and clawback as standard.

### **The risks we face**

The magnitude and urgency of the change we need to bring about is a major additional challenge to delivering 'business as usual'. This has its risks and opportunities. These range from how good we prove to be at delivering our plans, to the pace of economic recovery and impact of unforeseen events. The five main risk factors I believe that we need to be alert to are:

- the economic environment,
- our ability to sell or run down those businesses that we are seeking to exit,
- how long it takes us to get to a position whereby we lend only what we take in deposits, and the stability of funding along the way,
-

regulatory pressure and requirements from the EU, from HMG (especially around the APS) and from regulators, in particular the Financial Services Authority, and

- our own ability to implement the plans we have set out.

There is much that we can and are getting on with now and although I cannot be certain how long it will take us to achieve our vision, or how difficult the journey will be, I am confident that we have the right people and the right roadmap to get there.

### **Chief Executive's letter to shareholders (continued)**

#### **Towards the new RBS**

There is every sign that our financial performance over the next two years, at a Group level, will be poor due to the severe economic downturn in 2008 and 2009 and consequent impact on impairments and funding costs. But, once successfully restructured, each of our businesses will be highly attractive and valuable in its own right. Each will have a strong customer base, offer shareholders a sustainable return and potential for growth, and each will be disciplined in its use of capital and funding.

We will have businesses that are connected and that work together; sharing costs and expertise to improve the service they provide to customers, and doing so more efficiently. In addition, across RBS as a whole, our businesses will 'complement' each other so that we have a balanced mix of funding sources, ways of generating income, stable earnings and options for growth.

This combination of operational synergy and a balanced portfolio means that each business will have a greater value as part of RBS than it does standing alone. But we will continue to be rational in assessing our business mix and changes may occur where so merited.

There is a lot of hard work to be done before we know the level of success and therefore the ultimate value of the restructuring plan and of RBS. But I am heartened and encouraged by the effort, determination and commitment that I see from colleagues across the Group. They are rising to what is probably the greatest professional challenge we will ever face. At the end of it, I believe we will have earned our way back to the respect, self and otherwise, that our company so badly needs.

Stephen Hester

Group Chief Executive

Gogarburn, Edinburgh

7 August 2009



## **Business and strategic update**

### **Financial performance - pro forma results**

#### **Group organisational structure**

Following the conclusion of the Strategic Review, the Group has realigned its Core divisions, including in particular the separation of RBS UK into UK Retail and UK Corporate. A Non-Core division has also been established to manage and run off or dispose of a number of assets and businesses that do not meet the Group's target criteria. Further details of the new divisional structure are on page 27. The initial discussion of Group performance relates to both Core and Non-Core operations. Commentary on divisional performance on pages 31-55 relates to Core activities only.

#### **Group operating performance**

The Group delivered strong income generation, up 27% to £14,791 million, with expenses up 4% to £8,733 million to yield operating profit before impairment losses of £4,167 million in the first half of 2009, compared with £1,331 million in the first half of 2008. At constant exchange rates, income rose by 21% while costs declined by 5%, with Group operating profit before impairment losses up 270%. Impairments, however, rose sharply to £7,521 million, compared with £1,479 million in the first half of 2008. Over 70% of the impairment costs arose in the Non-Core division, but the Group also experienced a significant rise in credit costs in all core divisions, reflecting the continuing deterioration in economic conditions. Approximately 70% of the impairments and write-downs incurred in the first half are attributable to assets covered by the Asset Protection Scheme, subject to any changes to the Scheme, where some important issues remain open.

After a gain of £3,790 million on the redemption of a number of outstanding debt securities, the Group recorded profit before tax, excluding the write-down of goodwill and other intangible assets, of £15 million, compared with a loss of £726 million in the same period of 2008. After tax, minority interests and preference share dividends the loss attributable to ordinary shareholders was £1,042 million, up 26% from the loss recorded in the first half of 2008. This represents a basic loss per ordinary share of 2.2p, including discontinued operations.

#### **Group margin**

Group net interest margin fell to 1.69%, compared with 2.07% in the first half of 2008 and 2.08% for the full year 2008. While new business asset margins have improved, these will take some time to feed through to the back book and have so far fallen well short of the increase in funding costs. In the very low interest rate environment prevailing in all the Group's major markets, deposit pricing floors and active competition have compressed liability margins. In addition, markedly increased costs of term funding and of increasing our stock of liquid assets have contributed to the reduction in net interest margin.

In these prevailing conditions, margins in the core banking divisions are expected to remain under pressure in the second half.

### **Business and strategic update (continued)**

#### **Group credit and risk metrics**

Loan impairments increased to £6,796 million in the first half, representing 2.25% of gross loans and advances excluding reverse repos, on an annualised basis, compared with 0.83% in the first half of 2008 and 1.33% in the second half of 2008. Impairments continued to increase in the second quarter, particularly in the Group's UK retail and

corporate banking divisions, and included an incremental provision on our UK corporate book, to reflect the materially increased flow of companies into restructuring during the period. While a degree of stabilisation has occurred in financial markets, the impact of economic recession continues to feed through into the Group's credit portfolios.

Non-performing and potential problem loans at 30 June 2009 totalled £31.0 billion, an increase of 246% from 30 June 2008, or 236% at constant exchange rates, and of 63% from 31 December 2008, or 69% at constant exchange rates. These categories represented 5.08% of gross loans and advances, excluding reverse repos, compared with 1.47% at 30 June 2008 and 2.69% at 31 December 2008.

Provision coverage was 44%, a decrease of 12% compared with 30 June 2008 and a decrease of 6% compared with 31 December 2008. The declining trend is mainly attributable to the increasingly secured composition of the Group's non performing loan portfolio. In addition, during the first half of 2009, a small number of large corporate exposures assessed as requiring limited provisions, because of the structure of the transactions and the expected restructuring outcomes, moved into the non-performing category.

The availability of equity funding in the capital markets has provided some relief to companies, particularly in the UK, but corporate default rates have continued to rise. While personal unsecured lending has been reduced, arrears on these exposures have continued to increase, in line with rising unemployment trends. Arrears on residential mortgage lending have risen more modestly, with the arrears rate on the NatWest and RBS UK mortgage portfolio increasing to 1.8% at 30 June 2009 from 1.16% at 30 June 2008 and 1.5% at December 2008. The average loan-to-value for new business was 65% in the first half of 2009 versus 67% for 2008.

The Group has made good progress in strengthening its risk management practices, with the implementation of updated limit frameworks for credit and market risk and further refinement of the credit approval process.

## **Business and strategic update** (continued)

### **Group balance sheet, capital and funding**

The Group made good progress in its financial restructuring during the first six months of 2009, achieving a reduction of £574 billion in total assets to £1,644 billion - a fall of 26%. Excluding mark-to-market derivative assets, third party assets were reduced by £139 billion to £1,089 billion, principally reflecting substantial repayments of loans to banks and customers and a reduction of 17%, or 13% in constant currency terms, in trading assets. Mark-to-market derivative assets fell by 44% to £556 billion, with a corresponding fall in derivative liabilities.

Group risk-weighted assets totalled £547.3 billion at 30 June 2009, an increase of £55.6 billion from June 2008 but a decrease of £30.5 billion from December 2008. Although the Group has continued to reduce its balance sheet throughout the half year, the pro-cyclical effects of the Basel 2 methodology have resulted in higher risk-weightings. Undrawn facilities and other commitments to lend have been reduced to £296.6 billion, down 6% from June 2008 and 15% from December 2008. The effect of currency movements during the latter half of 2008, in particular the marked weakening of sterling against the dollar, has been partially reversed during the first half of 2009. On a constant currency basis RWAs were up 4% from June 2008 and flat compared with December 2008.

The Group's Core Tier 1 ratio at 30 June 2009 was 6.4%, compared with 5.3% a year earlier, reflecting the preference share conversion and debt exchange carried out earlier this year, as well as 2008 equity issuance.

In April, the Group concluded a series of exchange offers and tender offers with the holders of a number of Tier 1 and Upper Tier 2 securities which resulted in an aggregate pre-tax gain of £4.6 billion, of which approximately £3.8

billion was taken through income and the remainder through equity.

The Asset Protection Scheme announced in February and related capitalisations, when concluded, is expected to further strengthen the Group's capital ratios, as the assets covered by the Scheme will carry lower risk weightings as a result of UK Government asset insurance. This augments the impact of RBS's own extensive restructuring measures. The scheme is currently expected to provide approximately £150 billion of risk-weighted asset relief. In addition, HM Treasury will subscribe to a total of £19.5 billion of new B Shares qualifying as capital on implementation of the APS, with a further £6 billion as a contingent reserve. The APS should strengthen Core Tier 1 by more than 5% pro forma. This figure is RBS's current estimate and subject to finalisation of the detailed terms and conditions, confirmation of asset eligibility and pricing (all of which require state aid approval) and without taking account of the £6 billion contingent tranche of B share issuance outlined in February.

### **Business and strategic update** (continued)

While the quantum of funding available in the markets has increased, funding costs remain high compared with pre-crisis levels. Money market conditions have improved, with spreads between Libor and overnight indexed swap rates narrowing somewhat, though they remain substantially in excess of average levels experienced in previous years. The short and medium end of the yield curve remains steep.

The Group's average credit spreads in the first half were significantly higher than in the same period of 2008 but spreads have now narrowed from their peaks. During the period the Group was able to resume issuance of term debt without the requirement for a government guarantee and has made significant progress towards extending the maturity profile of its funding. It has also made good progress in building up its liquidity portfolio, although this has been at the expense of margins.

The Group's loan:deposit ratio improved from 152% at December 2008 to 144% at June 2009. Each division has been set targets for further improvements in this ratio over the next five years, and these are outlined on page 22.

### **Core Bank**

The Core Bank achieved a good recovery in operating performance in the first half, with underlying operating profit before tax, purchased intangibles amortisation, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangibles, integration and restructuring costs, up 33% to £6,294 million.

Operating income grew strongly, reflecting favourable trading conditions during the first half, with strong volumes and volatility benefiting Global Banking & Markets. There were more modest improvements in Wealth and Global Transaction Services, offset to a significant degree by increased funding costs. The core UK retail and corporate banking businesses put in a resilient performance, with severe margin attrition from higher deposit and funding costs but some improvement in new asset margins. Non-interest income was also affected by slower economic conditions. Total income rose by 25%, or 16% on a constant currency basis, to £17,793 million, with net interest income 8% lower at £6,043 million and non-interest income 54% higher at £11,750 million.

Expense discipline remained good, both in the customer-facing divisions and in Manufacturing operations, with total expenses up 7% to £7,745 million. On a constant currency basis, expenses were reduced by 2%. Operating profit before impairment losses increased by 57% to £8,471 million, or by 45% at constant exchange rates. The Group has made good progress in its £2.5 billion expense reduction programme, with £0.6 billion of cost savings delivered in the first half.

Impairments increased markedly across all banking divisions, totalling £2,177 million, an increase of 225% from the first half of 2008. Impairments in the second quarter were 11% higher than in the first, with a small net recovery in GBM but incremental impairments taken to reflect the accelerating flow of credit problems in the UK corporate sector, and a further increase in personal delinquencies in the UK and US, in line with the continuing deterioration in economic conditions and the rising level of unemployment.

## **Business and strategic update** (continued)

### **Non-Core Division**

Non-Core division third party assets at 30 June 2009, including derivatives, totalled £231.1 billion, down from £324.7 billion at 31 December 2008. The division recorded an operating loss of £9,648 million in the first half, driven largely by credit market and other write-downs of £4.2 billion and impairments of £5.3 billion. Approximately 44% of the assets of the Non-Core division are expected to be covered by the Asset Protection Scheme.

The Group has established targets for a reduction of approximately £230 billion in Non-Core's third party assets, excluding derivatives mark to market, by 2013, as compared with December 2008. This includes asset run-off of approximately £200 billion as well as £50 billion to £60 billion of asset sales, offset by rollovers and additional drawings. Achieving this run-off profile will depend on sufficient recovery in market conditions to allow assets to be disposed of at acceptable valuations, and on the securitisation or sale of some APS assets in the outer years of the five year plan, for which HM Treasury's permission may be needed.

### **Disposals**

In January the Group announced that it had disposed of its 4.26% equity stake in Bank of China for a net consideration of £1.6 billion.

In April 2009 the Group disposed of its 50% stake in Linea Directa Aseguradora to its joint venture partner, Bankinter, for a cash consideration of €426 million. This disposal is consistent with the Group strategy announced on 26 February 2009. As a 50/50% joint venture, Linea Directa Aseguradora had operated as a largely independent Spanish insurance operation with limited connection to the Group.

RBS announced on 4 August 2009 that it had reached agreement with ANZ on the sale of a number of its Asian assets, and remains in advanced discussions on the sale of its remaining Asian retail and commercial businesses.

### **Asset Protection Scheme**

Although full documentation of the Asset Protection Scheme has not yet been finalised, the key terms of the APS were agreed in principle and announced in February. RBS's most recent APS submission is for coverage of assets with a gross value of £316 billion and a carrying value, net of impairments and write-downs incurred before 1 January 2009, of £294 billion. These assets are individually identified and documented and comprise primarily corporate loans, bonds and mortgages, as well as more complex credit exposures such as collateralised debt obligations and derivative transactions with monoline insurers.

Subject to the detailed terms and conditions of the Scheme and state aid approval, RBS will bear the first loss on these specified assets up to £19.5 billion, plus historical impairments and write-downs. Once this first loss is exceeded, HMT will bear 90% of further losses, while the remaining 10% of the losses will remain with RBS. The APS applies to losses incurred on or after 1 January 2009 in respect of assets held on RBS's balance sheet as at 31 December 2008.

**Business and strategic update** (continued)

The Group will pay a fee of £6.5 billion for this protection. In addition, it has agreed to forgo certain tax reliefs, including the ability to carry back 2008 losses to 2007. RBS's agreement to forfeit these tax reliefs will continue until 31 December 2013 when the Group returns to profitability, whichever occurs earlier. The cost of this tax agreement will depend on results but is currently estimated at £9-11 billion.

Before RBS's participation in the APS can begin, state aid clearance must also be received by the UK Government from the European Commission in respect of all aspects of the scheme including asset coverage and pricing. As referenced in the Chief Executive's letter on page 10, both the terms of the APS announced in February and the asset coverage outlined above remain open and may change as negotiations continue with HM Treasury and the European Commission regarding the Scheme. This remains an important risk factor for RBS.

**UK Lending Commitments**

In February, as a result of the APS, the Group agreed to make available an additional £25 billion of lending to creditworthy customers on commercial terms, and subject to market demand, over the ensuing 12 months, and a similar amount over the following year. In the first four months since entering into this commitment RBS has achieved strong results in the mortgage market, with gross lending over £7 billion despite generally weak demand, and remains on track to achieve its targets. UK mortgage balances, including Ulster at 30 June 2009 totalled £80.8 billion, up 9% year on year and 5% higher than at the end of 2008.

In business markets, RBS has achieved gross new lending of £28.6 billion. However, demand has been comparatively muted, with companies cutting inventories and expansion plans and reducing their bank borrowing requirements. Additionally, the anticipated withdrawal of non-UK and wholesale-funded lenders which has characterised the mortgage market has not occurred in corporate markets, and the anticipated "gap" in the market for creditworthy corporate borrowers has not emerged. After taking account of loan repayments and overdraft movements, RBS's UK business lending, including Ulster, at 30 June 2009 totalled £155.1 billion, a decrease of 1% from 30 June 2008 and a decline of 4% since the end of 2008.

In the SME segment of business markets, gross lending in the first half totalled £17 billion notwithstanding weaker demand. However, repayments have been accelerating since the third quarter of 2008, leaving balances at the end of June of £66.6 billion, up 2% from June 2008. As a result of RBS's price pledge, 94% of customers who renewed their overdrafts in the second quarter of 2009 did so at the same margin or lower and in June, the average interest rate paid by customers on term loans was half its level a year earlier. Total credit applications in the first half were down 22% on the same period of 2008. While there has been some recovery in recent months in the number of applications for term loans, the average size of each application has fallen, reflecting, among other factors, falling property values. As a result, term loan applications by value were 37% lower. The acceptance rate across all categories of SME credit remains stable at 85%.

Among larger corporates, RBS advanced £12 billion of gross new lending in the first half. However, many larger companies are actively deleveraging, and RBS has helped many of its clients to raise new finance in the equity and bonds markets, which has been used to reduce bank borrowing substantially. Demand for acquisition finance remains minimal.

**Business and strategic update** (continued)

RBS has undertaken a range of initiatives aimed at demonstrating that it remains open for business, and is determined to do its part in meeting demand for lending from creditworthy homeowners and businesses. There have been some

recent signs of a modest increase in demand in certain segments of the market, but in the absence of a more general recovery in borrowing appetite the targets will remain challenging.

	30 June	31 December	Gross lending	Net	30 June
	2008	2008	during H1	lending	2009
	£bn	£bn	2009	during H1	£bn
			£bn	2009	
			£bn	£bn	
Mortgages	74.2	76.7	7.2	4.1	80.8
Total Business	156.8	162.4	28.6	(7.3)	155.1
SME	65.0	66.9	17.0	(0.3)	66.6
Mid-corporate	47.3	49.4	7.3	(2.6)	46.8
Large corporate	44.5	46.1	4.3	(4.4)	41.7
Total Lending	231.0	239.1	35.8	(3.2)	235.9

Lending figures represent drawn balances, with the exception of Large Corporate figures, which are committed lending (as per RBS's Lending Commitments agreement). Wealth lending balances, unsecured personal lending and non-UK lending are not included in the above data.

### Customer Franchises

Crucial to the Group's prospects for future success and return to standalone health is the resilience of its customer franchises. It was, therefore, significant that, excepting the extensive activities earmarked for restructuring, run-off or exit, RBS generally sustained its customer market positions during the first half despite the headwinds of reputational damage and financial weakness. In the UK personal sector, the RBS and NatWest banking brands made good headway, increasing the number of current account customers to 12.6 million, up 3% from June 2008, and the number of savings accounts to 9.7 million, up 18%. Our mortgage business has also made particularly good progress despite weak market demand, driven by the requirement to fulfil our lending commitments with market share increased from historically modest levels as wholesale-funded lenders have pulled out of the market. UK Corporate maintained its market-leading position among businesses, ranking first in customer satisfaction. Ulster Bank increased consumer accounts by 5%, while Citizens achieved good success in converting mortgage customers into checking account customers, with checking accounts up 2% to 4.1 million, and increased the number of business checking account customers by 3%. In GBM, good progress was made in chosen market positions, moving from fifth to fourth in the Euromoney global foreign exchange rankings and sustaining top 3 positions in key government bond markets. A number of other market shares slipped back, reflecting deliberate strategy and business disruption. RBS Insurance achieved a strong performance, with own-brand motor policies up 8% and own-brand non-motor policies also up 8%.

### Business and strategic update (continued)

#### Core Bank - divisional targets

As part of the Group's strategic plan, targets have been established for each division. These targets do not constitute forecasts, but it is the Group's intention to make measurable progress towards these goals during the period covered.

Return on equity for the banking divisions is defined as divisional operating profit (after tax) divided by divisional notional equity (based on 7% of divisional risk-weighted assets (except for Global Banking & Markets, 10% and UK Corporate, 8% of RWAs) adjusted for regulatory capital deductions.

**UK Retail**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	>1	<60	<120
<b>2013</b>	>15	c.50	<105

**UK Corporate**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	>5	<45	<135
<b>2013</b>	>15	<35	<130

**GBM**

	<b>Return on equity %</b>	<b>Cost:income %</b>
<b>2011</b>	c15	<65
<b>2013</b>	15-20	c.55

**GTS**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	n.m.	c.55	<25
<b>2013</b>	n.m.	<50	<20

**Wealth**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	n.m.	<60	<35
<b>2013</b>	n.m.	<50	<30

**Ulster Bank**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	>0	<75	<175
<b>2013</b>	>15	c.50	<150

**US Retail & Commercial**

	<b>Return on equity %</b>	<b>Cost:income %</b>	<b>Loans:deposits %</b>
<b>2011</b>	c.10	<70	<90
<b>2013</b>	>15	<55	<90

**Insurance**

	<b>Return on equity %</b>	<b>Cost:income less claims %</b>
<b>2011</b>	>15	<70
<b>2013</b>	>20	<60

**Outlook**

The exceptionally favourable market conditions from which GBM benefited in the first half of 2009 are not expected to continue in the second half, and this is likely to have a material effect on Core Bank operating income. In the retail and corporate banking divisions, income is expected to be more stable. Costs are expected to remain well controlled, while impairments are expected to remain at elevated levels. Restructuring charges will continue to be a feature over the next three years.

**Summary consolidated income statement****for the half year ended 30 June 2009 - pro forma (unaudited)**

In the income statements set out below, amortisation of purchased intangible assets, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangible assets and integration and restructuring costs are shown separately. In the statutory condensed consolidated income statement on page 147, these items are included in income and operating expenses as appropriate. First half 2008 and full year 2008 have been restated for the amendment to IFRS 2 'Share-based payment'.

	<b>First half 2009</b>	<b>First half 2008</b>	<b>Change %</b>	<b>Full Year 2008</b>
	<b>£m</b>	<b>£m</b>	<b>%</b>	<b>£m</b>
<b>Core</b>				
<b>Net interest income</b>	<b>6,043</b>	6,581	(8)	13,587
Non-interest income (excluding insurance net premium income)	<b>9,533</b>	5,235	82	6,127
Insurance net premium income	<b>2,217</b>	2,376	(7)	4,723
<b>Non-interest income</b>	<b>11,750</b>	7,611	54	10,850



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<b>Total income (1)</b>	<b>17,793</b>	14,192	25	24,437
<b>Operating expenses (2)</b>	<b>(7,745)</b>	(7,218)	7	(13,856)
<b>Profit before other operating charges</b>	<b>10,048</b>	6,974	44	10,581
Insurance net claims	<b>(1,577)</b>	(1,589)	(1)	(3,217)
<b>Operating profit before impairment losses</b>	<b>8,471</b>	5,385	57	7,364
Impairment losses	<b>(2,177)</b>	(670)	-	(2,512)
<b>Operating profit (3)</b>	<b>6,294</b>	4,715	33	4,852
<b>Non-Core</b>				
<b>Net interest income</b>	<b>612</b>	920	(33)	2,177
Non-interest income (excluding insurance net premium income)	<b>(4,054)</b>	(3,946)	3	(7,001)
Insurance net premium income	<b>440</b>	485	(9)	986
<b>Non-interest income</b>	<b>(3,614)</b>	(3,461)	4	(6,015)
<b>Total income (1)</b>	<b>(3,002)</b>	(2,541)	18	(3,838)
<b>Operating expenses (2)</b>	<b>(988)</b>	(1,175)	(16)	(2,332)
<b>Operating loss before other operating charges and impairment losses</b>	<b>(3,990)</b>	(3,716)	7	(6,170)
Insurance net claims	<b>(314)</b>	(338)	(7)	(700)
Impairment losses	<b>(5,344)</b>	(809)	-	(4,920)
<b>Operating loss (3)</b>	<b>(9,648)</b>	(4,863)	98	(11,790)

For definitions of the notes see page 26.

**Summary consolidated income statement**

**for the half year ended 30 June 2009 - pro forma (unaudited) (continued)**

	<b>First half</b>	First half		Full Year
	<b>2009</b>	2008	Change	2008
	<b>£m</b>	£m	%	£m
<b>Summary consolidated income statement</b>				
<b>Total</b>				
<b>Net interest income</b>	<b>6,655</b>	7,501	(11)	15,764
Non-interest income (excluding insurance net premium income)	<b>5,479</b>	1,289	-	(874)

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Insurance net premium income	<b>2,657</b>	2,861	(7)	5,709
<b>Non-interest income</b>	<b>8,136</b>	4,150	96	4,835
<b>Total income (1)</b>	<b>14,791</b>	11,651	27	20,599
<b>Operating expenses (2)</b>	<b>(8,733)</b>	(8,393)	4	(16,188)
<b>Profit before other operating charges</b>	<b>6,058</b>	3,258	86	4,411
Insurance net claims	<b>(1,891)</b>	(1,927)	(2)	(3,917)
<b>Operating profit before impairment losses (3)</b>	<b>4,167</b>	1,331	-	494
Impairment losses	<b>(7,521)</b>	(1,479)	-	(7,432)
<b>Operating loss (3)</b>	<b>(3,354)</b>	(148)	-	(6,938)
Amortisation of purchased intangible assets	<b>(140)</b>	(262)	(47)	(443)
Integration and restructuring costs	<b>(734)</b>	(316)	132	(1,357)
Gain on redemption of own debt	<b>3,790</b>	-	-	-
Strategic disposals	<b>453</b>	-	-	442
<b>Operating profit/(loss) before tax (4)</b>	<b>15</b>	(726)	-	(8,296)
Tax	<b>412</b>	303	36	1,280
<b>Profit/(loss) from continuing operations</b>	<b>427</b>	(423)	-	(7,016)
Loss from discontinued operations, net of tax	<b>(58)</b>	(41)	41	(86)
<b>Profit/(loss) for the period</b>	<b>369</b>	(464)	180	(7,102)
Minority interests	<b>(554)</b>	(148)	-	(412)
Preference share and other dividends	<b>(546)</b>	(215)	154	(596)
<b>Loss attributable to ordinary shareholders before write-down of goodwill and other intangible assets</b>	<b>(731)</b>	(827)	(12)	(8,110)
Write-down of goodwill and other intangible assets	<b>(311)</b>	-	-	(16,196)
<b>Loss attributable to ordinary shareholders</b>	<b>(1,042)</b>	(827)	26	(24,306)

For definitions of the notes see page 26.

**Condensed consolidated statement of comprehensive income  
for the half year ended 30 June 2009 (unaudited) - pro forma**

	<b>First half</b>	First half	Full year
	<b>2009 £m</b>	2008 £m	2008 £m
<b>Profit/(loss)/ for the period</b>	<b>58</b>	(464)	(23,298)

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Other comprehensive income:			
Available-for-sale financial assets	(1,633)	(1,615)	(7,270)
Cash flow hedges	521	(123)	(405)
Currency translation	(2,447)	733	7,327
Actuarial losses on defined benefit plans	-	-	(1,807)
Tax on other comprehensive income	408	491	2,572
<b>Other comprehensive income for the period, net of tax</b>	<b>(3,151)</b>	<b>(514)</b>	<b>417</b>
<b>Total comprehensive income for the period</b>	<b>(3,093)</b>	<b>(978)</b>	<b>(22,881)</b>
<b>Attributable to:</b>			
Equity shareholders	(3,146)	(936)	(23,148)
Minority interests	53	(42)	267
	<b>(3,093)</b>	<b>(978)</b>	<b>(22,881)</b>

**Summary consolidated balance sheet**

**at 30 June 2009 (unaudited) - pro forma**

	30 June	31 December
	2009	2008
	£m	£m
Loans and advances to banks	83,700	129,499
Loans and advances to customers	640,762	731,265
Debt securities and equity shares	243,279	275,357
Derivatives and settlement balances	579,134	1,009,307
Other assets	97,570	73,265
<b>Total assets</b>	<b>1,644,445</b>	<b>2,218,693</b>
Owners' equity	55,666	58,879
Minority interests	2,123	5,436
Subordinated liabilities	32,106	43,678
Deposits by banks	179,743	262,609
Customer accounts	490,282	518,461
Derivatives, settlement balances and short positions	594,914	1,023,673
Other liabilities	289,611	305,957
<b>Total liabilities and equity</b>	<b>1,644,445</b>	<b>2,218,693</b>

**Key metrics (pre-APS)**

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	<b>First half</b>	First half		Full Year
	<b>2009</b>	2008	Change	2008
<b>Performance ratios</b>				
Return on equity (5)	<b>(18.1%)</b>	(2.0%)	(1610bp)	(13.9%)
Net interest margin	<b>1.69%</b>	2.07%	(38bp)	2.08%
Cost:income ratio (8)	<b>59.0%</b>	72.0%	(1,300bp)	78.6%
Adjusted cost:income ratio (9)	<b>67.7%</b>	86.3%	(1,860bp)	97.0%
Basic loss per ordinary share from continuing operations	<b>(2.1p)</b>	(6.4p)	4.3p	(146.2p)
				31
	<b>30 June</b>	30 June		December
	<b>2009</b>	2008		2008
<b>Capital and balance sheet</b>				
Funded balance sheet (10)	<b>£1,088.6bn</b>	£1,247.9bn	(13%)	£1,227.2bn
Risk-weighted assets	<b>£547.3bn</b>	£491.7bn	11%	£577.8bn
Core tier 1 ratio	<b>6.4%</b>	5.3%	110bp	5.9%
Tier 1 ratio	<b>9.0%</b>	8.6%	40bp	9.9%
Non-performing loans	<b>£30.7bn</b>	£8.8bn	-	£18.8bn
Non-performing loans as a % of loans and advances	<b>5.01%</b>	1.45%	356bp	2.67%
Provision balance as % of NPL/PPLs	<b>44%</b>	57%	(1,200bp)	50%
Loan:deposit ratio	<b>144.5%</b>	137.3%	720bp	152.4%
Tier 1 leverage ratio (6)	<b>21.7x</b>	28.7x	(24%)	21.2x
Tangible equity leverage ratio (7)	<b>3.0%</b>	2.1%	90bp	2.4%
Net tangible equity per share	<b>58.0p</b>	159.5p	(64%)	73.8p

Notes:

- (1) Excluding gain on redemption of own debt and strategic disposals.
- (2) Excluding purchased intangibles amortisation, write-down of goodwill and other intangible assets, integration and restructuring costs.
- (3) (Loss)/profit before tax, purchased intangibles amortisation, gain on redemption of own debt, strategic disposals, write-down of goodwill and other intangible assets, integration and restructuring costs.
- (4) Excluding write-down of goodwill and other intangible assets.
- (5) Loss before tax, purchased intangibles amortisation, integration and restructuring costs, gain on redemption of own debt, strategic disposals and write-down of goodwill and other intangible assets divided by average ordinary shareholders equity.
- (6) The Tier 1 leverage ratio is based on total tangible assets (after netting derivatives) divided by Tier 1 capital.
- (7) The tangible equity leverage ratio is based on total tangible equity divided by total tangible assets (after netting derivatives).
- (8) The cost:income ratio is based on total income and operating expenses as defined in (1) and (2) above.
- (9) The adjusted cost:income ratio is based on total income and operating expenses as defined in (1) and (2) above and after netting insurance claims against income.
- (10) Funded balance sheet is defined as total assets less derivatives.

## Description of business

**UK Retail** offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through the RBS and NatWest networks of branches and ATMs in the United Kingdom, and also through telephone and internet channels.

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

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

**Global Banking & Markets** 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. The division is organised along seven principal business lines: money markets; rates flow trading; currencies; commodities (including RBS Sempra Commodities LLP, the commodities-marketing joint venture between RBS and Sempra Energy); equities; credit markets and portfolio management & origination.

**Global Transaction Services** ranks among the top five global transaction services providers, offering global payments, cash and liquidity management, and 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.

**Ulster Bank** is the leading retail and commercial bank in Northern Ireland and the third largest banking group on the island of Ireland. It provides a comprehensive range of financial services through both its Retail Markets division which has a network of branches and operates in the personal and bancassurance sectors, while its Corporate Markets division provides services to SME business customers, corporates and institutional markets.

**US Retail & Commercial** provides financial services primarily through the Citizens and Charter One brands. US Retail 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. It ranks among the top five banks in New England and the Mid Atlantic regions.

**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 Germany and Italy. The Intermediary and Broker division sells general insurance products through independent brokers.

**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. 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 is the Group's centre of excellence for managing large-scale and complex change.

### Description of business (continued)

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

**Non-Core Division** manages separately assets that the Group intends to run off or dispose of. The division contains a range of businesses and asset portfolios primarily from the GBM division, linked to proprietary trading, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also includes a number of other portfolios and businesses including regional markets businesses that the Group has concluded are no longer strategic.

### Divisional performance

The operating profit/(loss) of each division before amortisation of purchased intangible assets, write-down of goodwill and other intangible assets, integration and restructuring costs, gain on redemption of own debt and strategic disposals.

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full Year 2008 £m
<b>Operating profit before impairment losses</b>				
UK Retail	<b>877</b>	954	(8)	1,772
UK Corporate	<b>872</b>	1,035	(16)	1,965
Wealth	<b>240</b>	190	26	377
Global Banking & Markets	<b>5,110</b>	1,132	-	(774)
Global Transaction Services	<b>509</b>	497	2	1,103
Ulster Bank	<b>149</b>	190	(22)	324
US Retail & Commercial	<b>318</b>	417	(24)	965
RBS Insurance	<b>223</b>	300	(26)	626
Central items	<b>173</b>	670	(74)	1,006
Core	<b>8,471</b>	5,385	57	7,364
Non-Core	<b>(4,304)</b>	(4,054)	(6)	(6,870)
<b>Group operating profit before impairment losses</b>	<b>4,167</b>	1,331	-	494
Included in the above are movements in fair value of own debt of:				
Global Banking & Markets	<b>164</b>	584	(72)	357
Central items	<b>(93)</b>	228	(141)	875
	<b>71</b>	812	(91)	1,232

**Impairment losses by division**

UK Retail	<b>824</b>	440	87	1,019
UK Corporate	<b>551</b>	96	-	321
Wealth	<b>22</b>	5	-	16
Global Banking & Markets	<b>237</b>	17	-	541
Global Transaction Services	<b>13</b>	4	-	48
Ulster Bank	<b>157</b>	18	-	106
US Retail & Commercial	<b>369</b>	126	193	437
RBS Insurance	<b>6</b>	-	-	42
Central items	<b>(2)</b>	(36)	(94)	(18)
<b>Core</b>	<b>2,177</b>	670	-	2,512
<b>Non-Core</b>	<b>5,344</b>	809	-	4,920
<b>Group impairment losses</b>	<b>7,521</b>	1,479	-	7,432

**Operating profit/(loss) by division**

UK Retail	<b>53</b>	514	(90)	753
UK Corporate	<b>321</b>	939	(66)	1,644
Wealth	<b>218</b>	185	18	361
Global Banking & Markets	<b>4,873</b>	1,115	-	(1,315)
Global Transaction Services	<b>496</b>	493	1	1,055
Ulster Bank	<b>(8)</b>	172	(105)	218
US Retail & Commercial	<b>(51)</b>	291	(118)	528
RBS Insurance	<b>217</b>	300	(28)	584
Central items	<b>175</b>	706	(75)	1,024
<b>Core</b>	<b>6,294</b>	4,715	33	4,852
<b>Non-Core</b>	<b>(9,648)</b>	(4,863)	98	(11,790)
<b>Group operating loss</b>	<b>(3,354)</b>	(148)	-	(6,938)

**Divisional performance** (continued)

	<b>First half</b>	First half		Full Year
	<b>2009 £m</b>	2008 £m	Change %	2008 £m
<b>Analysis of impairment losses</b>				
Loan impairment losses	<b>6,796</b>	1,406	-	6,478
Impairment losses on available-for-sale securities	<b>725</b>	73	-	954
<b>Total impairment losses</b>	<b>7,521</b>	1,479	-	7,432
	<b>2.22%</b>	0.46%	176bp	0.91%

Loan impairment charge as % of gross loans and advances  
excluding reverse repurchase agreements

	<b>30 June</b>	30 June	31 December
	<b>2009</b>	2008	2008
	<b>£bn</b>	£bn	£bn
<b>Risk-weighted assets by division</b>			
UK Retail	<b>54.0</b>	44.7	45.7
UK Corporate	<b>85.1</b>	84.9	81.5
Wealth	<b>10.5</b>	10.4	11.0
Global Banking & Markets	<b>126.6</b>	137.7	166.5
Global Transaction Services	<b>16.7</b>	16.9	17.1
Ulster Bank	<b>26.2</b>	21.5	24.5
US Retail & Commercial	<b>55.6</b>	44.8	63.9
Other	<b>8.6</b>	8.2	7.0
Core	<b>383.3</b>	369.1	417.2
Non-Core	<b>164.0</b>	122.6	160.6
<b>Total risk-weighted assets</b>	<b>547.3</b>	491.7	577.8

## UK Retail

	<b>First</b>			
	<b>half</b>	First half	Change	Full year
	<b>2009</b>	2008		2008
	<b>£m</b>	£m	%	£m
Net interest income	<b>1,684</b>	1,530	10	3,229
Net fees and commissions - banking	<b>658</b>	814	(19)	1,524
Other non-interest income (net of insurance claims)	<b>122</b>	139	(12)	227
Non-interest income	<b>780</b>	953	(18)	1,751
Total income	<b>2,464</b>	2,483	(1)	4,980
Direct expenses				
- staff	<b>(428)</b>	(445)	(4)	(924)
- other	<b>(221)</b>	(219)	1	(436)
Indirect expenses	<b>(938)</b>	(865)	8	(1,848)
	<b>(1,587)</b>	(1,529)	4	(3,208)



Operating profit before impairment losses	<b>877</b>	954	(8)	1,772
Impairment losses	<b>(824)</b>	(440)	87	(1,019)
Operating profit	<b>53</b>	514	(90)	753

**Analysis of income by product:**

Personal advances	<b>609</b>	633	(4)	1,234
Mortgages	<b>480</b>	219	119	497
Personal deposits	<b>741</b>	998	(26)	2,013
Bancassurance	<b>122</b>	132	(8)	217
Cards	<b>416</b>	418	-	831
Other	<b>96</b>	83	16	188
Total income	<b>2,464</b>	2,483	(1)	4,980

**Analysis of impairment by sector:**

Mortgages	<b>63</b>	13	-	31
Personal	<b>494</b>	255	94	568
Cards	<b>267</b>	172	55	420
	<b>824</b>	440	87	1,019

## Loan impairment charge as % of gross customer loans and advances by sector

Mortgages	<b>0.16%</b>	0.04%	12bp	0.04%
Personal	<b>7.01%</b>	3.29%	372bp	3.76%
Cards	<b>8.75%</b>	5.06%	369bp	6.67%
Total	<b>1.70%</b>	0.96%	74bp	1.09%

**UK Retail** (continued)

	<b>First half 2009 £bn</b>	First half 2008 £bn	Change %	Full year 2008 £bn
<b>Performance ratios</b>				
Return on equity (1)	<b>1.8%</b>	19.3%	(1,750bp)	13.7%
Net interest margin	<b>3.62%</b>	3.52%	10bp	3.62%
Cost:income ratio	<b>63.7%</b>	60.0%	370bp	62.1%
	<b>30 June 2009</b>	30 June 2008	Change	31 December 2008

	£bn	£bn	%	£bn
<b>Capital and balance sheet</b>				
Loans and advances to customers - gross				
- mortgages	<b>76.9</b>	69.7	10	72.4
- personal	<b>14.1</b>	15.5	(9)	15.1
- cards	<b>6.1</b>	6.8	(10)	6.3
Customer deposits (excluding bancassurance)	<b>83.4</b>	76.6	9	78.9
Assets under management - excluding deposits	<b>4.7</b>	6.6	(29)	5.7
Non-performing loans	<b>4.5</b>	3.3	36	3.8
Loan:deposit ratio (excluding repos)	<b>116.4%</b>	120.1%	(370bp)	118.9%
Risk-weighted assets	<b>54.0</b>	44.7	21	45.7

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

UK Retail banking income declined marginally with growth in net interest income offset by declining fees. However, impairment losses have continued to rise, reflecting the wider economic environment, and consequently the division reported a much reduced operating profit of £53 million in the first half.

Net interest income grew by 10% to £1,684 million, driven by growth in both loan and deposit balances. Net interest margin increased slightly to 3.62% (2008 - 3.52%), with improved asset pricing, primarily in mortgages, offsetting the impact of the low interest rate environment on savings margins. Continued competitive pressure on savings margins and reduced volumes in unsecured lending may put pressure on the net interest margin in coming periods.

Non-interest income declined 18% to £780 million. Of this decline, £117 million reflected the withdrawal of the single premium payment protection insurance product and lower related income due to higher claims, with the remainder being largely due to the impact of the weak economic environment on credit card, private banking and bancassurance fees.

Direct expenses were reduced by 2% to £649 million, with a 4% reduction in direct staff costs reflecting lower staff compensation and the benefits of cost saving initiatives. Indirect costs rose by 8% to £938 million, including the effect of an additional £61 million Financial Services Compensation Scheme Levy. Total costs increased by 4% and the cost:income ratio deteriorated to 63.7%.

#### **UK Retail** (continued)

Impairment losses increased by 87% to £824 million reflecting the deterioration in the economic environment, and its impact on customer finances. The mortgage impairment charge was £63 million (2008 - £13 million) on a total book of £76.9 billion, while the unsecured lending impairments charge was £761 million (2008 - £427 million) on a book of £20.2 billion. Impairment provisions have been increased to reflect the reduction in expected cash recoveries. In mortgages, arrears rates remain below the industry average as reported by the Council of Mortgage Lenders. Repossessions have not increased as RBS seeks to support its customers in difficult times wherever possible. Current expectations are for the upward pressure on impairments to continue for the remainder of this year and into 2010.

Loans and advances to customers increased by 6% with particularly strong growth in mortgage lending, which grew by 10%. The strong performance in mortgages reflects good volumes of new business delivered primarily through organic channels as well as very good customer retention resulting from a competitively priced product range. Gross mortgage lending market share increased to 10.5% (2008 - 6.5%) and the Group is on track to deliver its commitments to the Government on net lending. Unsecured lending has continued to slow reflecting reduced customer demand and rising risk.

Customer deposits have grown 9% reflecting the strength of the UK Retail customer franchise in an increasingly competitive environment and despite depressed market growth. This is essential in order to fund the increased lending. Personal current account customers increased 3% both year on year and annualised in the first half to 12.6 million. Personal savings accounts increased 18% year on year to 9.7 million. The division's loan:deposit ratio improved by 4 percentage points compared with June 2008 to 116%.

Risk-weighted assets increased 21% to £53.8 billion, reflecting the upward pressure from procyclicality, including the impact of rising default probability and reduced levels of expected recoveries reflecting house price declines.

RBS continues to progress towards a more convenient, lower cost operating model, with over 3.8 million active users of online banking. A record share of new sales was achieved through direct channels. In the first half 700,000 additional accounts switched to paperless statements, taking the total number of paperless accounts to 2.3 million. In support of this lower cost operating model there has also been a 6% FTE reduction year on year. In Branches, a significant number of 'Cash & Deposits Machines' (CDMs) have been rolled out, giving customers in 121 branches access to this technology. The machines can accept cheque, notes and coin deposits, and can provide an 'image' receipt for customer reassurance.

## UK Corporate

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	<b>1,006</b>	1,194	(16)	2,344
Net fees and commissions	<b>387</b>	377	3	791
Other non-interest income	<b>182</b>	218	(17)	388
Non-interest income	<b>569</b>	595	(4)	1,179
Total income	<b>1,575</b>	1,789	(12)	3,523
Direct expenses				
- staff	<b>(342)</b>	(368)	(7)	(752)
- other	<b>(106)</b>	(137)	(23)	(288)
Indirect expenses	<b>(255)</b>	(249)	2	(518)
	<b>(703)</b>	(754)	(7)	(1,558)
Operating profit before impairment losses	<b>872</b>	1,035	(16)	1,965
Impairment losses	<b>(551)</b>	(96)	-	(321)

Operating profit	<b>321</b>	939	(66)	1,644
Analysis of income by business:				
Corporate and commercial lending	<b>692</b>	792	(13)	1,460
Asset and invoice finance	<b>233</b>	245	(5)	486
Corporate deposits	<b>544</b>	573	(5)	1,246
Other	<b>106</b>	179	(41)	331
Total income	<b>1,575</b>	1,789	(12)	3,523
Analysis of impairment by sector:				
Manufacturing	<b>21</b>	10	110	25
Housebuilding and construction	<b>61</b>	5	-	18
Property	<b>167</b>	7	-	71
Asset and invoice finance	<b>68</b>	38	79	102
Other	<b>234</b>	36	-	105
Total impairment	<b>551</b>	96	-	321
Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements by sector:				
Manufacturing	<b>0.88%</b>	0.44%	44bp	0.47%
Housebuilding and construction	<b>2.30%</b>	0.19%	211bp	0.31%
Property	<b>1.02%</b>	0.05%	97bp	0.22%
Asset and invoice finance	<b>1.55%</b>	0.92%	63bp	1.20%
Other	<b>0.92%</b>	0.13%	79bp	0.19%
	<b>1.08%</b>	0.18%	90bp	0.30%

**UK Corporate** (continued)

	<b>First half</b>	First half		Full year
	<b>2009</b>	2008	Change	2008
	<b>£bn</b>	£bn	%	£bn
<b>Performance ratios</b>				
Return on equity (1)	<b>6.3%</b>	19.6%	(1,330bp)	17.5%
Net interest margin	<b>2.14%</b>	2.64%	(50bp)	2.54%
Cost:income ratio	<b>44.6%</b>	42.2%	240bp	44.2%

	<b>30 June</b>	30 June		31
	<b>2009</b>	2008	Change	December
	<b>£bn</b>	£bn	%	2008
				£bn
<b>Capital and balance sheet</b>				
Total assets	<b>106.0</b>	108.2	(2)	109.8
Loans and advances to customers - gross				
- Manufacturing	<b>4.8</b>	4.5	7	5.3
- Housebuilding and construction	<b>5.3</b>	5.4	(2)	5.8
- Property	<b>32.9</b>	29.2	13	32.1
- Asset and invoice finance	<b>8.8</b>	8.3	6	8.5
- Other	<b>50.6</b>	57.0	(11)	54.1
Customer deposits	<b>84.1</b>	83.9	-	79.9
Non-performing loans	<b>2.4</b>	0.9	167	1.3
Loan:deposit ratio	<b>121.8%</b>	124.5%	(270bp)	132.4%
Risk-weighted assets	<b>85.1</b>	84.9	-	81.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 8% of divisional risk-weighted assets, adjusted for capital deductions).

The first half of 2009 has been a challenging period, with operating profit falling to £321 million. Results were severely affected by worsening income and higher impairments, partially offset by cost reductions. Increases in the cost of funding, the low base rate environment and lower levels of economic activity reduced margins, driving income lower by 12%, while costs were reduced by 7%. Impairment losses were significantly higher at £551 million.

Net interest income fell by 16% to £1,006 million with narrowed margins as a result of the significant increase in the cost of funding. New business margins on lending have widened, partly reflecting repricing from Base rate to LIBOR to better reflect the Group's costs of funding. Deposit margins narrowed sharply as savings floors were reached on a range of deposit products, although the impact on net interest income was partly mitigated by hedging programmes. Overall, net interest margin reduced by 50 basis points to 2.1%, and is expected to remain under pressure while interest rates remain low and deposit competition strong.

Non-interest income has also been adversely impacted by the slowdown in the UK economy, with lower levels of activity across most sectors leading to a 4% fall to £569 million.

Total direct costs fell by 11% to £448 million, reflecting lower staff compensation and a business-wide cost reduction programme which will generate further savings into the second half. Indirect costs from Manufacturing and Group Central functions increased by 2% to £255 million.

### UK Corporate (continued)

Impairment losses increased materially to £551 million. While there was a rise in the number of significant corporate delinquencies requiring a specific provision, increased impairments of £271 million have also been recognised to

cover losses in the portfolio not yet specifically identified. The impairment charge has been biased towards the housebuilding, property and construction sectors, but this is expected to spread more widely as the adverse economic conditions begin to impact other sectors of the economy for the remainder of 2009.

Loans and advances to customers were slightly down compared with 30 June 2008 at £102.4 billion. The division has stepped up its efforts to provide support to UK businesses, reflecting the lending commitments made in February to HM Government. Demand for credit, however, remains subdued, with the value of applications for Business & Commercial term loans 37% lower than in the first half of 2008

Deposit balances remained stable at £84.1 billion, building on the improved stability and confidence provided by the recapitalisations of 2008. Specific campaigns aimed at generating new deposits have yielded benefits in the first half of the year. Improving our capability and product offering is a key step in improving deposit-gathering performance. The loan:deposit ratio improved from 132% at the end of 2008 to 122% at June 2009.

Risk-weighted assets were stable at £85 billion, compared with June 2008, but increased by 4% from December 2008, reflecting the effect of procyclicality under Basel 2.

## Wealth

	<b>First half 2009</b>	First half 2008	Change	Full year 2008
	<b>£m</b>	£m	%	£m
Net interest income	<b>339</b>	271	25	588
Net fees and commissions	<b>182</b>	212	(14)	409
Other non-interest income	<b>43</b>	39	10	77
Non-interest income	<b>225</b>	251	(10)	486
Total income	<b>564</b>	522	8	1,074
Direct expenses				
- staff	<b>(169)</b>	(187)	(10)	(379)
- other	<b>(68)</b>	(72)	(6)	(156)
Indirect expenses	<b>(87)</b>	(73)	19	(162)
	<b>(324)</b>	(332)	(2)	(697)
Operating profit before impairment losses	<b>240</b>	190	26	377
Impairment losses	<b>(22)</b>	(5)	-	(16)
Operating profit	<b>218</b>	185	18	361
Analysis of income:				
Private Banking	<b>469</b>	395	19	835
Investments	<b>95</b>	127	(25)	239

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Total income	<b>564</b>	522	8	1,074
	<b>£bn</b>	£bn	Change %	£bn

**Performance ratios**

Net interest margin	<b>4.64%</b>	4.42%	22bp	4.52%
Cost:income ratio	<b>57.5%</b>	63.6%	(610bp)	64.9%

	<b>30 June 2009</b>	30 June 2008	Change	31 December 2008
	<b>£bn</b>	£bn	%	£bn

**Capital and balance sheet**

Loans and advances to customers - gross

- mortgages	<b>5.8</b>	5.2	12	5.4
- personal	<b>4.7</b>	4.3	9	5.0
- other	<b>2.2</b>	1.8	22	2.2
Customer deposits	<b>35.7</b>	36.1	(1)	34.5
Assets under management - excluding deposits	<b>29.8</b>	34.7	(14)	34.7
Non-performing loans	<b>0.2</b>	0.1	-	0.1
Loan:deposit ratio	<b>35.6%</b>	31.3%	420bp	36.6%
Risk-weighted assets	<b>10.5</b>	10.4	1	11.0

**Wealth** (continued)

Wealth delivered a resilient performance with income growing by 8% to £564 million and operating profit increasing by 18% to £218 million. Increases in income and reductions in direct costs were partly offset by higher provisions and higher internal allocations for support services.

Net interest income rose 25% to £339 million, primarily driven by increased internal pricing applied to the Wealth deposit base. The effect of this change improved divisional income, compared with the first half of 2008, by £89 million. Reported income also benefited from the appreciation of the Swiss franc against sterling. At constant exchange rates net interest income was 21% higher. Deposit balances have continued to grow in the second quarter of 2009 and recovered much of the outflow seen in the last quarter of 2008, demonstrating the underlying strength of the division's client relationships. The effect of lower base rates, and to a lesser extent lower average balances in the first half of 2009 (down 2% compared with the first half of 2008), was partially offset by an uplift in lending income. New deposit products have been designed to match evolving client needs for yield and liquidity. Lending volumes were strong, up 12%, particularly in mortgages and small business. Lending margins have improved, particularly for mortgages, and credit metrics for new business remain satisfactory.

Non-interest income, primarily comprising fees and commissions (for lending, payments and investments) declined 10% to £225 million as a result of two major factors: first, the significant fall in equity markets (the FTSE 100 index at 30 June 2009 was 24% lower than a year earlier while the S&P 500 index was down 28% for the same period) lowered overall investment portfolio values; second, ongoing lack of investor appetite led to lower than expected

investment product sales as well as a preference for lower margin products. Furthermore, investors' use of leverage in investment portfolios was significantly lower. Together these contributed to an overall decline in investment assets under management of 14% to £29.8 billion.

Direct expenses fell 9% to £237 million reflecting three major influences: an increase due to foreign exchange effects (with the Swiss franc strengthening versus sterling), a decrease in remuneration and a further decrease from cost management. Headcount has been reduced 3% to 5,013. Indirect expenses increased by 19% to £87 million due to higher Group Centre allocations, most notably the Financial Services Compensation Scheme levies. At constant exchange rates total expenses were reduced by 8%.

Impairment losses increased by £17 million to £22 million, reflecting some isolated instances of difficulty in UK and offshore mortgage books (representing second property mortgages for expatriates). Impairment losses as a percentage of lending to customers increased to 0.35% (annualised).

Customer numbers have held steady, increasing by 1% compared with June 2008 despite the significant shrinkage in the population of high net worth individuals.

## Global Banking & Markets

	<b>First half</b>	First half	Change	Full year
	<b>2009 £m</b>	2008 £m	%	2008 £m
Net interest income from banking activities	<b>1,560</b>	868	80	2,473
Net fees and commissions receivable	<b>728</b>	643	13	1,259
Income from trading activities	<b>5,733</b>	2,234	157	116
Other operating income (net of related funding costs)	<b>(191)</b>	(69)	177	(170)
Non-interest income	<b>6,270</b>	2,808	123	1,205
Total income	<b>7,830</b>	3,676	113	3,678
Direct expenses				
- staff	<b>(1,787)</b>	(1,603)	11	(2,433)
- other	<b>(539)</b>	(640)	(16)	(1,356)
Indirect expenses	<b>(394)</b>	(301)	31	(663)
	<b>(2,720)</b>	(2,544)	7	(4,452)
Operating profit/(loss) before impairment losses	<b>5,110</b>	1,132	-	(774)
Impairment losses	<b>(237)</b>	(17)	-	(541)
Operating profit/(loss)	<b>4,873</b>	1,115	-	(1,315)

Analysis of income by product:



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Rates - money markets	<b>1,356</b>	500	171	1,150
Rates - flow	<b>1,942</b>	1,403	38	1,445
Currencies	<b>976</b>	699	40	1,524
Commodities	<b>467</b>	349	34	798
Equities	<b>733</b>	561	31	368
Credit markets	<b>1,452</b>	(1,028)	-	(3,496)
Portfolio management and origination	<b>740</b>	608	22	1,532
Fair value of own debt	<b>164</b>	584	(72)	357
<b>Total income</b>	<b>7,830</b>	3,676	113	3,678

Analysis of impairment by sector:

Manufacturing and infrastructure	<b>39</b>	-	-	39
Property and construction	<b>50</b>	12	-	12
Transport	<b>1</b>	-	-	-
Telecommunications, media and technology	<b>-</b>	-	-	-
Banks and financial institutions	<b>43</b>	(9)	-	185
Other	<b>104</b>	14	-	305
	<b>237</b>	17	-	541

Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements	<b>0.37%</b>	0.02%	35bp	0.27%
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**Global Banking & Markets** (continued)

	<b>First half 2009 £bn</b>	First half 2008 £bn	Change %	Full year 2008 £bn
<b>Performance ratios</b>				
Return on equity (1)	<b>51.6%</b>	11.4%	4,020bp	(5.6%)
Net interest margin	<b>1.69%</b>	0.93%	76bp	1.26%
Cost:income ratio	<b>34.7%</b>	69.2%	(3,450bp)	121.0%

	<b>30 June 2009 £bn</b>	30 June 2008 £bn	Change %	31 December 2008 £bn
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**Capital and balance sheet**

Loans and advances (including banks)	<b>166.4</b>	175.2	(5)	236.4
Reverse repos	<b>75.2</b>	179.9	(58)	88.8
Securities	<b>115.5</b>	147.6	(22)	127.5
Cash and eligible bills	<b>51.5</b>	48.6	6	20.2

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Other	<b>46.3</b>	47.6	(3)	42.9
Total third party assets (excluding derivatives mark to market)	<b>454.9</b>	598.9	(24)	515.8
Net derivative assets (after netting)	<b>70.7</b>	57.0	24	113.0
Customer deposits (excluding repos)	<b>66.0</b>	82.8	(20)	90.2
Non-performing loans	<b>1.1</b>	0.4	175	0.7
Loan:deposit ratio	<b>195.8%</b>	174.0%	2,180bp	200.6%
Risk-weighted assets	<b>126.6</b>	137.7	(8)	166.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 10% of divisional risk-weighted assets, adjusted for capital deductions).

Following a particularly strong first quarter performance, notably in its rates and currencies businesses, Global Banking & Markets (GBM) continued to deliver robust income across all business lines throughout the first half of 2009. Total income was £7,830 million, up 113% from the first half of 2008. Costs were up 7% and credit impairments rose sharply, resulting in a first half 2009 operating profit of £4,873 million. On a constant currency basis total income was up 86% from the first half of 2008, while costs fell 1%.

The performance was particularly creditable given the immense pressures of business restructuring following 2008 losses. Significant people issues arising from competitors' hiring activities resulted in a net loss of people and revenues from GBM. GBM's ability to benefit from favourable market conditions demonstrates the core strength of its franchise. It is important to note, however, that first half revenues are likely to prove unsustainable, with a significantly lower run-rate expected in the second half of 2009.

Net interest income grew 80% to £1,560 million, with money markets income showing an especially strong performance, driven by global interest rate movements and volatility. Portfolio margins have improved, reflecting the rapid repricing taking place in the market. Fees and commissions rose 13% to £728 million, while income from trading activities advanced markedly to £5,733 million.

### Global Banking & Markets (continued)

By business line, the rates flow business saw continued good performance in the first half of 2009 with increased market volatility and strong customer demand, albeit at a more moderate level in the second quarter than in the first, which saw exceptional levels of activity. This resulted in a 38% increase in income to £1,942 million. The currencies business continued to make good progress in consolidating its leading position, generating income of £976 million in the first half of 2009, up 40%. The Sempra Commodities joint venture, which began in April 2008, contributed income of £467 million for the first half of 2009. Money markets delivered very strong revenue of £1,356 million, benefiting from the rapid reduction in short-term rates.

Core equities and equity derivatives performed well in an active market. Core equities revenue growth was driven by a strong equity capital markets (ECM) performance, with RBS rising from 5th to 4th position in Non-US ECM from the first half of 2008 to the first half of 2009.

As the impact of various government schemes globally began to take effect credit markets benefited from greater liquidity and a more positive trading environment, driving increased activity particularly in the US liquid mortgage trading business. The legacy illiquid mortgage origination and trading portfolio that incurred losses in 2008 has been substantially closed out.

Portfolio management income remained resilient and debt capital markets origination revenues grew strongly across both Corporate and FI client sectors. Total portfolio management and origination income grew by 22% to £740 million for the first half of 2009. Gains on the fair value of own debt began to reverse as credit spreads narrowed, with a loss of £483 million booked in the second quarter compared with a gain of £647 million in the first quarter.

While total income grew by 113%, total expenses increased 7% to £2,720 million but reduced by 1% at constant exchange rates. Besides currency effects, the expense line reflects the inclusion of Semptra for the full six months and the phasing of performance-related accruals. Compensation structures have undergone far-reaching review to align reward with long-term value creation, adjusted for risk; the compensation ratio for the half year was 23%, at the lower end of the expected range for this ratio for the full year. The ratio is likely to increase modestly in 2010/11 as the full accounting impact of new deferral policies accrues. Notwithstanding adverse exchange rate movements, non-staff costs were cut by 16%, primarily reflecting restructuring and efficiency benefits. Headcount reduced by 1,500, or 8%, compared with June 2008. The overall cost:income ratio improved significantly to 34.7%, reflecting the exceptionally strong income performance.

Impairments increased sharply to £237 million, representing 0.37% of loans & advances to customers. This compares with 0.02% for the first half of 2008 which was the low point in the economic cycle.

### Global Banking & Markets (continued)

GBM's total third party assets excluding derivatives were reduced to £455 billion at 30 June 2009, a reduction of 24% on a year earlier, or 30% at constant exchange rates, reflecting continued progress in managing down the inventories supporting the trading businesses, with significant reductions in reverse repos and securities holdings. Within this, total loans and advances were £166 billion, a decrease of 5% from June 2008 or 13% at constant exchange rates, reflecting higher levels of corporate repayments particularly in Europe and the USA. GBM continued to provide direct support for key clients, notably in the UK, while at the same time facilitating their access to the global equity and debt capital markets. Net derivative assets totalled £70.7 billion, compared with £113.0 billion at 31 December 2008.

Risk-weighted assets reduced by 8% from a year earlier to £126.6 billion and were 24% lower than at 31 December 2008. The movement was principally affected by lower non-UK lending, reduced derivatives and foreign exchange movements.

Good progress was made in increasing market share in core markets, moving from fifth to fourth in the Euromoney global foreign exchange rankings and sustaining top 3 positions in key government bond markets. A number of other market shares slipped back, reflecting deliberate strategy and business disruption.

### Global Transaction Services

<b>First half 2009</b>	First half 2008	Change	Full year 2008
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	£m	£m	%	£m
Net interest income	<b>446</b>	445	-	939
Non-interest income	<b>782</b>	710	10	1,491
Total income	<b>1,228</b>	1,155	6	2,430
Direct expenses				
- staff	<b>(183)</b>	(179)	2	(363)
- other	<b>(72)</b>	(66)	9	(100)
Indirect expenses	<b>(464)</b>	(413)	12	(864)
	<b>(719)</b>	(658)	9	(1,327)
Operating profit before impairment losses	<b>509</b>	497	2	1,103
Impairment losses	<b>(13)</b>	(4)	-	(48)
Operating profit	<b>496</b>	493	1	1,055
Analysis of income by product:				
Domestic cash management	<b>404</b>	381	6	793
International cash management	<b>350</b>	344	2	723
Trade finance	<b>152</b>	110	38	240
Merchant acquiring	<b>260</b>	263	(1)	555
Commercial cards	<b>62</b>	57	9	119
Total income	<b>1,228</b>	1,155	6	2,430

	£bn	£bn	Change %	£bn
<b>Performance ratios</b>				
Net interest margin	<b>8.75%</b>	8.27%	48bp	8.27%
Cost: income ratio	<b>58.6%</b>	57.0%	(160bp)	54.6%

	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet</b>				
Total third party assets	<b>19.7</b>	21.0	(6)	22.5
Loans and advances	<b>13.8</b>	15.7	(12)	15.2
Customer deposits	<b>54.0</b>	59.7	(10)	62.0
Non-performing loans	<b>0.1</b>	-	-	0.1
Loan:deposit ratio	<b>26.4%</b>	27.6%	(120bp)	25.7%
Risk-weighted assets	<b>16.7</b>	16.9	(1)	17.1

### **Global Transaction Services (continued)**

Global Transaction Services increased operating profit by 1% to £496 million, with results benefiting from currency movements. Income increased by 6% to £1,228 million, but declined 2% at constant exchange rates. Expenses were up 9%, but 2% in constant currency terms, as cost savings and efficiencies offset the impact of prudent investment in staffing and infrastructure in the second half of 2008.

Growth was driven by a solid performance in cash management, where income rose 4% in the first half of the year to £754 million, with growth in UK and US domestic cash management. The division continued to win new cash management business, reflecting the strength of the domestic platforms and the international network.

In the UK domestic market income grew by 5% despite the low interest rate environment and increased competition for deposits. Average deposits increased 13% to £15 billion, attributable to growth with UK financial institutions. US domestic fee income benefited from re-pricing strategies implemented in the second half of 2008 as income grew 9%, with currency effects mitigating the migration of some balances to Citizens.

International cash management income increased by 2% but was 7% lower at constant exchange rates. Income benefited primarily from the increased internal pricing applied to the GTS deposit base, but this was more than offset by the negative impact on margins caused by low base rates. Average deposit balances remained stable, but there was some attrition of international deposit customers affecting the period end spot balances. Interest rates are negatively impacting deposit margins as zero rate floors are reached on a range of products. The continued benefit of overdraft re-pricing has increased margins on asset balances versus the first half of 2008. International fee income from payment transactions has increased 19% on H1 2008.

The trade finance business increased income by 38%, with improving penetration into the Asia-Pacific region. The strength of the product platform resulted in new customer mandates particularly in the UK corporate sector, where the Supply chain service has continued to expand.

Merchant services and commercial cards income remained stable at £322 million in the face of changing consumer spending patterns. The value of individual transactions has decreased together with a switch from credit card to debit card usage as households pay down debt. Volume growth in the UK domestic acquiring market was up 5%, exceeding UK economic growth, which partly offset the decreasing value of individual transactions. Commercial cards income grew 9% driven by improved margins, compensating for the downturn in corporate spending.

Total expenses for the division rose 9% in the first half of 2009 to £719 million, largely reflecting exchange rate movements, with direct expenses up 4% to £255 million and indirect expenses up 12% to £464 million. In constant currency terms, direct expenses were reduced by 1% as a result of the division's continued implementation of cost saving initiatives and operating model efficiencies, while indirect expenses increased by 4%. The cost: income ratio was 58.6%, a deterioration of 2.4% in constant currency terms.

Impairment losses were £13 million for the first half 2009, up from £4 million in the first half of 2008. Overall defaults remain modest at 0.1% of loans and advances.

**Global Transaction Services (continued)**

Average deposit balances for the period remained stable, but deposits at 30 June 2009 were down 10% on the first half of 2008, driven in part by US domestic transfers within the wider Group and some attrition in international cash management. Loans and advances were down 12% from June 2008 due to lower overdraft utilisation. In constant currency terms, deposits fell by 12% and loans and advances by 15%. Divisional net funding contribution has remained stable. Risk-weighted assets were 6% lower in constant currency terms.

**Ulster Bank**

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full year 2008 £m
Net interest income	<b>410</b>	392	5	773
Net fees and commissions	<b>85</b>	104	(18)	228
Other non-interest income	<b>23</b>	39	(41)	38
Non-interest income	<b>108</b>	143	(24)	266
Total income	<b>518</b>	535	(3)	1,039
Direct expenses				
- staff	<b>(170)</b>	(159)	7	(330)
- other	<b>(47)</b>	(46)	2	(93)
Indirect expenses	<b>(152)</b>	(140)	9	(292)
	<b>(369)</b>	(345)	7	(715)
Operating profit before impairment losses	<b>149</b>	190	(22)	324
Impairment losses	<b>(157)</b>	(18)	-	(106)
Operating (loss)/profit	<b>(8)</b>	172	(105)	218
Analysis of income by business:				
Corporate	<b>299</b>	319	(6)	618
Retail	<b>194</b>	197	(2)	396
Other	<b>25</b>	19	32	25
Total income	<b>518</b>	535	(3)	1,039
Analysis of impairment by sector:				
Mortgages	<b>23</b>	7	-	17
Corporate	<b>107</b>	-	-	44

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Other	27	11	145	45
	157	18	-	106

Loan impairment charge as % of gross customer loans and advances excluding reverse repurchase agreements by sector

Mortgages	0.29%	0.09%	20bp	0.09%
Corporate	1.00%	-	100bp	0.18%
Other	3.38%	0.92%	246bp	2.14%
	0.81%	0.10%	71bp	0.24%

**Ulster Bank** (continued)

	£bn	£bn	Change %	£bn
<b>Performance ratios</b>				
Return on equity (1)	(0.7%)	18.2%	(1,890bp)	10.1%
Net interest margin	1.95%	1.92%	3bp	1.89%
Cost:income ratio	71.2%	64.5%	670bp	68.8%

	30 June 2009 £bn	30 June 2008 £bn	Change %	31 December 2008 £bn
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**Capital and balance sheet**

Loans and advances to customers - gross

- mortgages	16.0	15.7	2	18.1
- corporate	21.2	18.8	13	23.8
- other	1.8	2.4	(25)	2.1
Customer deposits	18.9	22.9	(17)	24.3
Non-performing loans				
- mortgages	0.4	0.2	-	0.3
- corporate	1.1	0.2	-	0.8
- other	0.1	0.1	-	0.1
Loan:deposit ratio	206.3%	161.1%	4,520bp	181.1%
Risk-weighted assets	26.2	21.5	22	24.5

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

Ulster Bank's results have been severely affected by economic conditions across the island of Ireland. Income fell by 3%, or by 14% at constant exchange rates, to £518 million, reflecting reduced volumes and narrowing margins. Although expense growth remained under tight control, impairments rose sharply, resulting in an operating loss of £8 million.

Net interest income declined to £410 million in the first half of 2009, a reduction of 8% at constant exchange rates, with net interest margin up 3 basis points to 1.95%. There was some easing of wholesale funding costs over the course of the period, and a re-pricing of some new lending, but this was largely offset by the increasing cost of acquiring and retaining customer deposits. Margins are expected to decline reflecting the highly competitive deposit market. Loans to customers were flat year on year as new lending reduced significantly reflecting subdued demand, although redemption levels have also fallen. Ulster Bank remains on track to deliver its portion of the Group's lending commitments in Northern Ireland. Non-wholesale customer deposits were broadly flat reflecting the highly competitive deposit market in Ireland. Customer deposits were down by 21% in constant currency terms, primarily as a result of the impact of the Irish Government guarantee scheme and a reduction in wholesale deposits in the first quarter but this has since stabilised.

Non-interest income fell by 30% at constant currency rates in the first half of 2009 reflecting reduced fee income from bancassurance products sales and lower activity levels, particularly in the banking and Capital Markets businesses.

#### **Ulster Bank** (continued)

Direct expenses were £217 million, a reduction of 5% in constant currency terms, driven by a 4% reduction in staff costs, reflecting the initial benefits of the Bank's restructuring programme. On the same constant currency basis, other costs were 10% lower as a result of a range of cost reduction initiatives across the business, with indirect costs held flat.

Impairment charges increased to £157 million, reflecting the significant continuing deterioration in the Irish economic outlook and the resultant change in underlying credit metrics. Impairments are expected to continue to rise in the second half of 2009.

Ulster Bank continues to launch products aimed at supporting existing and new customers through the changing economic environment. These include the Momentum mortgage and Co-ownership Scheme in Northern Ireland and the Secure Step mortgage in the Republic of Ireland. For business customers, €1billion of funding has been made available across the island of Ireland including £250 million of SME funding in Northern Ireland. Support is also being provided to customers through the launch of the "MoneySense for Adults" and "Flex" propositions, as well as the "Small Business Can" website.

Ulster Bank launched its 'One Bank' programme in January which is on track for completion by the end of 2009. The programme will see the merger of the First Active and Ulster Bank businesses and the implementation of a number of cost management initiatives across all business areas. The creation of a single franchise across the island of Ireland will increase efficiency and result in further cost reductions whilst providing customers with an improved level of service. Customer numbers have grown across the Ulster Bank brand and across the island of Ireland, with strong growth in current and savings accounts driving a 5% increase in total consumer accounts compared with June 2008.



**US Retail & Commercial**

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full year 2008 £m	<b>First half 2009 \$m</b>	First half 2008 \$m	Change %	Full year 2008 \$m
Net interest income	<b>942</b>	774	22	1,726	<b>1,407</b>	1,529	(8)	3,200
Net fees and commissions	<b>407</b>	310	31	664	<b>608</b>	612	(1)	1,231
Other non-interest income	<b>97</b>	84	15	197	<b>144</b>	168	(14)	362
Non-interest income	<b>504</b>	394	28	861	<b>752</b>	780	(4)	1,593
Total income	<b>1,446</b>	1,168	24	2,587	<b>2,159</b>	2,309	(6)	4,793
Direct expenses								
- staff	<b>(402)</b>	(311)	29	(645)	<b>(600)</b>	(614)	(2)	(1,194)
- other	<b>(331)</b>	(142)	133	(354)	<b>(495)</b>	(281)	76	(654)
Indirect expenses	<b>(395)</b>	(298)	33	(623)	<b>(589)</b>	(588)	-	(1,157)
	<b>(1,128)</b>	(751)	50	(1,622)	<b>(1,684)</b>	(1,483)	14	(3,005)
Operating profit before impairment losses	<b>318</b>	417	(24)	965	<b>475</b>	826	(42)	1,788
Impairment losses	<b>(369)</b>	(126)	193	(437)	<b>(551)</b>	(249)	121	(811)
Operating (loss)/profit	<b>(51)</b>	291	(118)	528	<b>(76)</b>	577	(113)	977
Analysis of income by product:								
Mortgages and home equity	<b>272</b>	175	55	375	<b>407</b>	346	18	695
Personal lending and cards	<b>220</b>	157	40	333	<b>328</b>	310	6	617
Retail deposits	<b>433</b>	465	(7)	1,000	<b>647</b>	919	(30)	1,853
Commercial lending	<b>281</b>	179	57	405	<b>419</b>	354	18	751
Commercial deposits	<b>193</b>	169	14	377	<b>288</b>	334	(14)	698
Other	<b>47</b>	23	104	97	<b>70</b>	46	52	179
Total income	<b>1,446</b>	1,168	24	2,587	<b>2,159</b>	2,309	(6)	4,793
Average exchange rate								
- US\$/£	<b>1.494</b>	1.975		1.853				

**US Retail & Commercial** (continued)

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full year 2008 £m	<b>First half 2009 \$m</b>	First half 2008 \$m	Change %	Full year 2008 \$m
Analysis of impairment by sector:								
Residential mortgages	<b>35</b>	12	192	41	<b>52</b>	24	117	76
Home equity	<b>72</b>	25	188	67	<b>107</b>	50	114	125
Corporate & Commercial	<b>169</b>	40	-	181	<b>253</b>	78	-	335
Other consumer	<b>93</b>	49	90	148	<b>139</b>	97	43	275
	<b>369</b>	126	193	437	<b>551</b>	249	121	811

Loan impairment  
charge as % of gross  
customer loans and  
advances excluding  
reverse repurchase  
agreements by sector

Residential mortgages	<b>0.96%</b>	0.30%	66bp	0.43%	<b>0.87%</b>	0.30%	57bp	0.55%
Home equity	<b>0.91%</b>	0.37%	54bp	0.36%	<b>0.82%</b>	0.37%	45bp	0.46%
Corporate & Commercial	<b>1.65%</b>	0.47%	118bp	0.76%	<b>1.50%</b>	0.47%	103bp	0.97%
Other consumer	<b>2.25%</b>	1.35%	90bp	1.51%	<b>2.04%</b>	1.36%	68bp	1.92%
	<b>1.42%</b>	0.55%	87bp	0.71%	<b>1.29%</b>	0.55%	74bp	0.90%

**Performance ratios**

Return on equity (1)	<b>(1.7%)</b>	<b>12.1%</b>	(1,380bp)	7.7%	<b>(1.5%)</b>	12.0%	(1,350bp)	9.70%
Net interest margin	<b>2.31%</b>	<b>2.61%</b>	(30bp)	2.65%	<b>2.32%</b>	2.61%	(29bp)	2.68%
Cost:income ratio	<b>78.0%</b>	<b>64.2%</b>	1,380bp	62.7%	<b>78.0%</b>	64.2%	1,380bp	62.7%

	<b>30 June 2009 £bn</b>	30 June 2008 £bn	Change %	31 December 2008 £bn	<b>30 June 2009 £bn</b>	30 June 2008 £bn	Change %	31 December 2008 £bn
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**Capital and balance  
sheet**

Total assets	<b>75.6</b>	68.9	10	87.5	<b>124.4</b>	137.0	(9)	127.8
Loans and advances to customers (gross):								

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- Residential mortgages	<b>7.3</b>	8.0	(9)	9.5	<b>12.0</b>	15.9	(25)	13.9
- home equity	<b>15.9</b>	13.5	18	18.7	<b>26.1</b>	26.8	(3)	27.2
- corporate and commercial	<b>20.5</b>	16.6	23	23.7	<b>33.6</b>	33.0	2	34.7
- other consumer	<b>8.3</b>	7.2	15	9.8	<b>13.7</b>	14.4	(5)	14.3
Customer deposits	<b>60.2</b>	52.5	15	64.4	<b>99.0</b>	104.5	(5)	94.0
Non-performing loans								
- retail	<b>0.3</b>	0.1	-	0.2	<b>0.4</b>	0.2	-	0.3
- commercial	<b>0.1</b>	-	-	0.2	<b>0.3</b>	0.1	-	0.2
Loan:deposit ratio	<b>86.7%</b>	<b>87.4%</b>	(70bp)	96.6%	<b>86.7%</b>	87.4%	(70bp)	96.6%
Risk-weighted assets	<b>55.6</b>	44.8	24	63.9	<b>91.3</b>	89.2	2	93.2
Spot exchange rate - US\$/£	<b>1.644</b>	1.989		1.460				

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on 7% of divisional risk-weighted assets, adjusted for capital deductions).

### US Retail & Commercial (continued)

US Retail & Commercial Banking results were challenged by the recessionary economic environment in the United States and historically low interest rates. Credit conditions worsened as the housing market continued to deteriorate and unemployment rose, exacerbating already difficult conditions. As a result, income declined by 6% to \$2,159 million, producing an operating loss of \$76 million. In sterling terms, total income increased by 24% to £1,446 million with an operating loss of £51 million, reflecting a significant weakening of sterling against the dollar.

Net interest income was down 8% to \$1,407 million with lower net interest margin at 2.31% for the first half of 2009 compared with 2.61% for the first half of 2008. The low interest rate environment contributed to a decline of 30 basis points in deposit margins, only partially offset by wider loan margins, reflecting deteriorating credit conditions and tighter underwriting standards. Non-interest income was down 4% primarily due to lower gains, which declined by \$29 million. Net fees and commissions were flat, with higher mortgage origination fees resulting from record refinancing activity offsetting weaker consumer banking fees. Depending upon the prevailing rate environment and local market competition, net interest margins are expected to remain stable / range-bound in the second half, largely driven by pricing around deposits.

Total expenses increased by 14% to \$1,684 million, largely as a result of higher deposit insurance costs including a one-off FDIC special assessment of \$72 million, as well as increased costs relating to loan workout and collection activity which is expected to mitigate the impact of future impairments. Half year results include the successful execution of restructuring actions announced at the end of 2008. These actions impacted approximately 1,000 employees and resulted in savings of \$32 million reflected in the first half results. With income weak, the cost:income ratio deteriorated markedly to 78%.

Impairment losses totalled \$551 million in the first half of 2009 compared with \$249 million in the first half of 2008 impacting both the retail and commercial loan portfolios. Actual charge-offs were \$376 million or 0.87% of loans, an increase of 44bps compared with the first half of 2008. There was a net increase of \$175 million in provision balances in the half. Consumer loan delinquencies have continued to rise throughout the first half reflecting the difficult economic conditions, representing 1.80% of loans compared with 1.04% of loans in the first half of 2008. Likewise, commercial non-performing loans rose to 0.87% of total loans compared with 0.20% in the first half of 2008. The challenging economic environment continues to affect credit losses; however, Citizens' asset quality remains superior to peers as measured by non performing loans as a percentage of total loans.

Loans and advances were down 5% at \$85.4 billion reflecting mortgage securitisations and subdued customer demand, partly offset by a modest increase in commercial loan balances, which rose 2%. Total customer deposits including wholesale funding at 30 June 2009 were 5% lower at \$99 billion, principally due to a planned reduction in wholesale funding. However, despite a very competitive deposit market, core customer deposits were up 5% to \$99 billion, partly driven by strong growth in checking balances. The loan:deposit ratio improved to 87%.

### US Retail & Commercial (continued)

US Retail & Commercial is a top 5 bank in New England and the Mid Atlantic regions and is among the top five participants in eight out of the ten largest sub-markets in which it has a presence. Its strategy is based on building market share through dedicated marketing and competitive pricing strategies within its footprint and on capturing opportunities in underpenetrated segments by building relationships with small and medium-sized companies.

### RBS Insurance

	First half		Full year	
	2009	2008	Change	2008
	£m	£m	%	£m
Earned premiums	<b>2,225</b>	2,263	(2)	4,512
Reinsurers' share	<b>(85)</b>	(107)	(21)	(206)
Insurance net premium income	<b>2,140</b>	2,156	(1)	4,306
Net fees and commissions	<b>(187)</b>	(201)	(7)	(396)
Investment income	<b>115</b>	180	(36)	367
Other income	<b>97</b>	87	11	153
Total income	<b>2,165</b>	2,222	(3)	4,430
Direct expenses				
- staff	<b>(139)</b>	(145)	(4)	(286)
- other	<b>(121)</b>	(127)	(5)	(225)
Indirect expenses	<b>(131)</b>	(124)	6	(261)
	<b>(391)</b>	(396)	(1)	(772)

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Gross claims	(1,574)	(1,571)	-	(3,136)
Reinsurers' share	23	45	(49)	104
Net claims	(1,551)	(1,526)	2	(3,032)
Operating profit before impairment losses	223	300	(26)	626
Impairment losses	(6)	-	-	(42)
Operating profit	217	300	(28)	584
Analysis of income by product:				
Motor own-brand	972	959	1	1,942
Household and Life own-brands	414	400	4	806
Motor partnerships and broker	290	353	(18)	686
Household and Life, partnerships and broker	164	181	(9)	354
Other (International, commercial and central)	325	329	(1)	642
Total income	2,165	2,222	(3)	4,430
<b>Key business metrics</b>				
In-force policies (thousands)				
- Motor own-brand	4,789	4,424	8	4,492
- Own-brand non-motor (home, rescue, pet, HR24)	5,890	5,449	8	5,560
- Partnerships & broker (motor, home, rescue, pet, HR24)	5,609	6,417	(13)	5,898
- Other (International, commercial and central)	1,210	1,123	8	1,206
Gross written premium (£m)	2,270	2,224	2	4,384
<b>Performance ratios</b>				
Return on equity (1)	13.6%	18.8%	(520bp)	18.3%
Cost:income ratio	18.1%	17.8%	30bp	17.4%
Adjusted cost:income ratio (2)	63.7%	56.9%	680bp	55.2%
<b>Balance sheet</b>				
General insurance reserves - total (£m)	6,601	6,658	(1)	6,672

Note:

- (1) Return on equity is based on divisional operating profit after tax, divided by divisional notional equity (based on regulatory capital).
- (2) The adjusted cost:income ratio is based on total income and operating expenses above and after netting insurance claims against income.

**RBS Insurance** (continued)

For RBS Insurance, insurance premium income was stable at £2,140 million, reflecting 4% growth in the Group's own brands offset by a 10% decline in the partnerships and broker segment. This reflects the division's strategy of maximising profitability while focusing on growth in the Group's own-brand businesses. Investment income declined

by 36% to £115 million, largely as a result of a year over year reduction in interest rates. The division has a very conservative investment policy for its £8.4 billion of invested funds, with 84% in short duration deposits and fixed income bonds. Net fees and commissions payable were 7% lower, mainly as a result of lower sales of the creditor product. Operating profit in the first half was £217 million, a decline of £83 million or 28% from the first half of 2008, of which £71 million directly related to lower investment returns and impairment losses.

In the UK motor market, the Churchill and Privilege brands continued to be successfully deployed on selected price comparison web sites. Direct Line, Churchill and Privilege motor policy numbers increased by 2%, 22% and 13% respectively over the period. In total, over previous year, own-brand motor policy numbers have increased by 8% to 4.8 million.

In own-brand non-motor insurance RBS Insurance has continued to achieve strong sales through RBS and NatWest, where home insurance policies in force increased by 16%. Direct Line has achieved a 2% increase in the number of policy renewals in the period. In addition, Privilege and Churchill have grown home policies by 223% and 29% respectively, mainly due to successful entry onto price comparison websites. Overall own-brand non-motor policies in force have grown by 8% to 5.9 million.

Direct expenses improved by 4% to £260 million, mainly driven by lower staff costs and reduced marketing spend.

Net claims were 2% higher at £1,551 million due to increases in creditor claims, home claims relating to the very cold weather in the first quarter of 2009, and a rise in personal injury motor claims costs. Impairment losses of £6 million reflect impairments of available for sale securities.

Gross written premium increased by 2% over the period, reflecting the strong growth in own-brand businesses. Own-brand motor gross written premium increased by 10% year on year and own-brand home gross written premium increased by 11%.

The UK combined operating ratio for the first half of 2009, including manufacturing costs, rose to 95.3%, compared with 94.8% a year earlier, reflecting a higher loss ratio partly offset by an improved expense base.

In April 2009 the Group disposed of its 50% stake in Linea Directa to Bankinter, its joint venture partner. In 2008 it also disposed of its 50% stake in Tesco Personal Finance. All financial data have been restated to exclude Linea Directa and Tesco Personal Finance.

## Central items

	<b>First half 2009</b>	First half 2008	Change	Full year 2008
	£m	£m	%	£m
Fair value of own debt	<b>(93)</b>	228	(141)	875
Other	<b>268</b>	478	(44)	149
Central items not allocated	<b>175</b>	706	(75)	1,024

Funding and operating costs have been allocated to operating divisions, based on direct service usage, requirement for market funding and other appropriate drivers where services span more than one division. Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

Items not allocated amounted to a net credit of £175 million (first half 2008 - £706 million) and comprised an increase in the carrying value of own debt more than offset by a net credit on a number of other volatile items including foreign exchange translation and the impact of economic hedges which do not qualify for IFRS hedge accounting.

### Non-Core

	<b>First half</b>	First half		Full year
	<b>2009</b>	2008	Change	2008
	<b>£m</b>	£m	%	£m
Net interest income from banking activities	<b>612</b>	920	(33)	2,177
Net fees and commissions receivable	<b>256</b>	495	(48)	923
Loss from trading activities	<b>(4,276)</b>	(5,286)	(19)	(8,529)
Insurance net premium income	<b>440</b>	485	(9)	986
Other operating income	<b>(34)</b>	845	(104)	605
Non-interest income	<b>(3,614)</b>	(3,461)	4	(6,015)
Total income	<b>(3,002)</b>	(2,541)	18	(3,838)
Direct expenses				
- staff	<b>(259)</b>	(410)	(37)	(658)
- other	<b>(450)</b>	(509)	(12)	(1,135)
Indirect expenses	<b>(279)</b>	(256)	9	(539)
	<b>(988)</b>	(1,175)	(16)	(2,332)
Operating loss before other operating charges and impairment losses	<b>(3,990)</b>	(3,716)	7	(6,170)
Insurance net claims	<b>(314)</b>	(338)	(7)	(700)
Impairment losses	<b>(5,344)</b>	(809)	-	(4,920)
Operating loss	<b>(9,648)</b>	(4,863)	98	(11,790)
			Change	
			%	
<b>Performance ratios</b>				
Net interest margin	<b>0.49%</b>	0.83%	(34bp)	0.90%
Cost:income ratio	<b>(32.9%)</b>	(46.2%)	1,330bp	(60.8%)

	<b>30 June 2009 £bn</b>	30 June 2008 £bn	Change %	31 December 2008 £bn
<b>Capital and balance sheet*</b>				
Total third party assets (including derivatives)	<b>231.1</b>	276.3	(16)	324.7
Loans and advances to customers - gross	<b>166.3</b>	164.9	1	190.2
Customer deposits	<b>20.8</b>	25.1	(17)	26.5
Non-performing loans	<b>20.5</b>	3.5	-	11.2
Loan:deposit ratio	<b>819.6%</b>	654.7%	-	720.2%
Risk-weighted assets	<b>164.0</b>	122.6	34	160.6
Income by donating division:				
UK Retail	<b>3</b>	147	(98)	288
UK Corporate	<b>244</b>	324	(25)	609
Wealth	<b>209</b>	243	(14)	454
Global Banking & Markets	<b>(4,221)</b>	(3,957)	7	(6,694)
Global Transaction Services	<b>85</b>	60	42	132
Ulster Bank	<b>112</b>	191	(41)	317
US Retail & Commercial	<b>170</b>	162	5	342
RBS Insurance	<b>406</b>	543	(25)	1,105
Central items	<b>(10)</b>	(254)	(96)	(391)
	<b>(3,002)</b>	(2,541)	18	(3,838)

\* includes disposal groups.

#### Non-Core (continued)

	<b>First half 2009 £m</b>	First half 2008 £m	Change %	Full year 2008 £m
Included in income donated by Global Banking & Markets above are credit and other market write-downs as follows:				
Monoline exposures	<b>1,547</b>	2,120	(27)	3,090
CDPCs	<b>569</b>	80	-	615
Super senior CDOs	<b>537</b>	1,892	(72)	2,976
Leveraged finance	<b>-</b>	863	-	1,088
CLO's	<b>-</b>	113	-	240
Other credit exotics	<b>542</b>	361	50	947
Equities	<b>22</b>	36	(39)	948
Other	<b>35</b>	(61)	-	268



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	<b>3,252</b>	5,404	(40)	10,172
CDS Hedging	<b>996</b>	(148)	-	(1,690)
	<b>4,248</b>	5,256	(19)	8,482
Impairment losses by donating division:				
UK Retail	<b>34</b>	47	(28)	105
UK Corporate	<b>1,092</b>	106	-	508
Wealth	<b>156</b>	61	156	167
Global Banking & Markets	<b>2,987</b>	277	-	3,105
Global Transaction Services	<b>17</b>	6	183	11
Ulster Bank	<b>484</b>	78	-	420
US Retail & Commercial	<b>574</b>	234	145	604
	<b>5,344</b>	809	-	4,920
Loan impairment charge as % of gross customer loans and advances by donating division				
UK Retail	<b>2.34%</b>	1.67%	67bp	3.23%
UK Corporate	<b>8.94%</b>	0.92%	802bp	2.03%
Wealth	<b>12.19%</b>	5.13%	706bp	5.28%
Global Banking & Markets	<b>4.38%</b>	0.53%	385bp	1.90%
Global Transaction Services	<b>2.85%</b>	0.86%	199bp	0.78%
Ulster Bank	<b>5.97%</b>	1.07%	490bp	2.38%
US Retail & Commercial	<b>9.34%</b>	3.96%	538bp	3.88%
Total	<b>5.65%</b>	1.00%	465bp	2.20%

**Non-Core (continued)**

	<b>30 June</b>	30 June		31
	<b>2009</b>	2008	Change	December
	<b>£bn</b>	£bn	%	2008
				£bn
Loans and advances by donating division:				
UK Retail	<b>2.9</b>	5.6	(48)	3.3
UK Corporate	<b>24.4</b>	23.1	6	25.0
Wealth	<b>2.6</b>	2.4	8	3.2
Global Banking & Markets	<b>106.4</b>	105.7	1	123.7
Global Transaction Services	<b>1.2</b>	1.4	(14)	1.4
Ulster Bank	<b>16.2</b>	14.6	11	17.7
US Retail & Commercial	<b>12.3</b>	11.8	4	15.6
RBS Insurance	<b>0.2</b>	0.2	-	0.2
Group centre	<b>0.1</b>	0.1	-	0.1

	<b>166.3</b>	164.9	1	190.2
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## Risk-weighted assets by donating division:

UK Retail	<b>2.0</b>	5.0	(60)	2.0
UK Corporate	<b>18.9</b>	19.4	(3)	17.8
Wealth	<b>2.9</b>	3.4	(15)	3.7
Global Banking & Markets	<b>118.1</b>	72.5	63	112.6
Global Transaction Services	<b>1.9</b>	2.2	(14)	2.8
Ulster Bank	<b>8.4</b>	8.9	(6)	6.8
US Retail & Commercial	<b>11.5</b>	10.6	8	14.1
Group centre	<b>0.3</b>	0.6	-	0.8
	<b>164.0</b>	122.6	34	160.6

**Non-Core** (continued)

The establishment of the Non-Core Division of RBS was announced on 26 February 2009 as one of the key outcomes of the Group Strategic Review.

The Non-Core Division comprises a number of businesses and assets, including a number of overseas branches and subsidiaries which did not meet the target criteria of the new core bank. These criteria covered franchise strength, return on equity over the economic cycle, organic growth potential, capital and funding efficiency, and connectivity with other businesses of the Group.

The objective of the Division is to run off or dispose of the resulting pool of assets over a three to five year period whilst maximising shareholder value and minimising any negative impact on the core franchises of the bank. The Division will seek to achieve this first and foremost by optimising the timing, cost and method of exit of the Non-Core businesses and assets. The terms of the APS may constrain the Group in certain respects. In addition it will aim to achieve a reduction in the amount of capital and funding required to support the Group and over time to reduce the Group's cost base.

Following further detailed review of the Non-Core asset portfolio during the first half of 2009, a total of £325 billion of third party assets, as at 31 December 2008, were confirmed for transfer to the new Division. This total comprises £251 billion of on-balance sheet funded third party assets and £73 billion of derivative marked-to-market third party assets, compared with the estimates of £240 billion and £145 billion, respectively, announced on 26 February. In addition, the Division had outstanding undrawn commitments of £85 billion. The revised portfolio equates to £161 billion of RWAs, compared with £155 billion announced in February.

GBM's contribution made up 77% of starting third party assets (including derivative marked-to-market exposures) and 70% of RWAs comprising a number of illiquid medium to long-term structured finance lending books, exotic credits, illiquid asset-backed securities and proprietary trading assets. The balance of the Division's asset pool was contributed by other divisions in the Group and comprises a range of businesses and corporate, commercial and consumer loan books.

In order to provide a coherent management framework for the run-off and disposal of the Division's assets, a new management team has been established to exclusively focus on this task, utilising the Group's infrastructure. The opening asset pool has been divided into three groupings, each of which is managed on a global basis by one or more executives:

- Banking & Portfolio comprises the structured finance portfolios - mainly real estate finance, leveraged finance and project and asset-based finance which originated within GBM.
- Retail, Commercial & Countries mainly comprises the retail, commercial and in some cases wholesale banking activities of the Group in the UK and overseas locations which have been determined to be non-core.
- Trading comprises a number of exotic credit and highly illiquid asset-backed securities and proprietary trading books.

### **Non-Core** (continued)

Approximately 44% of the assets (50% of RWAs) in the Non-Core Division are expected to be covered by the UK Asset Protection Scheme (APS). The precise extent of the asset coverage and the terms of APS are still under negotiation with HMT. RBS also intends to clarify the eligibility of certain Ulster Bank assets for the Irish Government's National Asset Management Agency scheme. Given the overlap and interdependencies between the APS and the Non-Core Division, the management of the two programmes is integrated within the Non-Core Division.

Between December 2008 and June 2009, total third party assets were reduced by £94 billion to £231 billion, including a £51 billion reduction in funded third party assets (excluding derivatives). The reduction in funded third party assets was assisted by foreign exchange movements, which resulted in a £14 billion decline. In addition, net balance run-off totalled £20 billion, and £9 billion of disposals were recorded, including the sale of Linea Directa in Spain (£0.5 billion) and Bank of China (£3.9 billion). Mark-to-market derivative assets decreased by £43 billion, largely as a result of the significant rally in credit markets which led to spreads tightening.

The Division has large hedging exposures on a number of portfolios, so a similar movement in mark-to-market derivative liabilities was recorded.

RWAs remained flat at £164 billion, compared with £161 billion in December 2008. The movements in RWAs were broadly consistent with the movements in nominal assets in Citizens, UK Retail, Wealth and Global Transaction Services. In the case of UK Corporate Banking and Ulster, nominal assets decreased but RWAs increased, primarily as a result of procyclicality.

Non-Core's GBM funded third party assets fell by a total of £36.3 billion, while its' RWAs increased by a net £5.6 billion. Reductions in RWAs as a result of foreign exchange rates (£8.7 billion), reductions in market risk (other than in relation to CDPC exposures) (£9.2 billion) the movement of certain counterparties to default status (causing their removal from the calculation) (£6.1 billion) and other reductions of £13.0 billion, were more than offset by increases in RWAs of £26.3 billion in respect of market and counterparty risk associated with CDPC exposures and of £16.3 billion, from the impact of procyclicality on probability of default and loss given default factors.

The Non-Core Division recorded an operating loss of £9,648 million in the first half of 2009. Net interest income was £612 million, down 33%, but non-interest income totalled a negative £3,614 million, including £4,248 million of credit market and other write-downs, compared with £5,256 million in the first half of 2008. These write-downs included £1,547 million of monoline losses, which were largely incurred in the first quarter and reflected the further

widening in monoline credit spreads in February. The Division uses a portfolio of CDSs to manage the capital consumption, concentration and credit risk of its loans. The CDSs are carried at fair value while the loans are recorded at cost less provisions for impairment. The tightening of spreads in the first half of 2009 reduced income by £996 million compared with a positive income impact of £148 million in the first half of 2008 and £1,690 million for full year 2008.

#### **Non-Core** (continued)

The operating loss was largely due to the increase in impairment charges, compared with the first half of 2008, on assets contributed by GBM (£2,709 million), UK Corporate (£986 million), US Retail & Commercial (£340 million) and Ulster (£406 million).

Targets have been set for a reduction of third party assets, excluding derivatives, to approximately £20 billion by 2013. This includes asset run-off of approximately £200 billion as well as £50 billion to £60 billion of asset sales, offset by rollovers and additional drawings. Achieving this run-off profile will depend on sufficient recovery in market conditions to allow assets to be disposed of at acceptable valuations, and on the securitisation or sale of some APS assets in the outer years of the five year plan, for which HM Treasury's permission may be required.

In the first half of 2009, a number of financial institutions and larger investment grade corporates with strong underlying businesses were able to take advantage of more favourable conditions in the bond and equity markets to refinance borrowing and generally deleverage their balance sheets in advance of their legal maturity. However, smaller corporates without access to the public markets and with less robust underlying businesses, which are more typical of the Non-Core asset portfolio, have continued to rely on their banks for finance. Given the economic environment, it is expected that a number of these businesses will require their banking facilities to be rolled over or refinanced or to make greater use of any undrawn committed facilities they may have in the remainder of this year. This trend is expected to continue into 2010.

In later years, financial markets and market liquidity may improve to a sufficient extent to allow access to alternative sources of finance, including securitisation, reducing the need to roll over banking facilities and allowing a reduction in commitments.

#### **Allocation methodology for indirect costs**

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

Group centre directly attributable costs have been allocated to the operating divisions, based on their service usage. Where services span more than one division, the costs are allocated on a basis management considers reasonable. The residual unallocated costs remaining in the Group centre, relate to volatile corporate items that do not naturally reside within a division.

Treasury costs are allocated to operating divisions as follows; term funding costs are allocated or rewarded based on long term funding gap or surplus; liquidity buffer funding costs are allocated based on share of overall liquidity buffer derived from divisional stresses; and capital cost or benefit is allocated based on share of divisional risk-adjusted RWAs.

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Change %</b>	<b>Full year 2008 £m</b>
<b>Manufacturing costs:</b>				
Property	<b>959</b>	815	<b>18</b>	1,705
Operations	<b>734</b>	716	<b>3</b>	1,471
Technology services and support functions	<b>930</b>	874	<b>6</b>	1,795
	<b>2,623</b>	2,405	<b>9</b>	4,971
Allocated to divisions:				
UK Retail	<b>(796)</b>	(791)	<b>1</b>	(1,636)
UK Corporate	<b>(219)</b>	(218)	<b>-</b>	(449)
Wealth	<b>(61)</b>	(59)	<b>3</b>	(123)
Global Banking & Markets	<b>(277)</b>	(228)	<b>21</b>	(472)
Global Transaction Services	<b>(431)</b>	(392)	<b>10</b>	(811)
Ulster Bank	<b>(132)</b>	(124)	<b>6</b>	(255)
US Retail & Commercial	<b>(360)</b>	(271)	<b>33</b>	(560)
RBS Insurance	<b>(113)</b>	(110)	<b>3</b>	(227)
Non-Core	<b>(234)</b>	(212)	<b>10</b>	(438)
	<b>-</b>	-	<b>-</b>	-
<b>Group centre costs</b>	<b>472</b>	314	<b>50</b>	799
Allocated to divisions:				
UK Retail	<b>(142)</b>	(74)	<b>92</b>	(212)
UK Corporate	<b>(36)</b>	(31)	<b>16</b>	(69)
Wealth	<b>(26)</b>	(14)	<b>86</b>	(39)
Global Banking & Markets	<b>(117)</b>	(73)	<b>60</b>	(191)
Global Transaction Services	<b>(33)</b>	(21)	<b>57</b>	(53)
Ulster Bank	<b>(20)</b>	(16)	<b>25</b>	(37)
US Retail & Commercial	<b>(35)</b>	(27)	<b>30</b>	(63)
RBS Insurance	<b>(18)</b>	(14)	<b>29</b>	(34)
Non-Core	<b>(45)</b>	(44)	<b>2</b>	(101)
	<b>-</b>	-	<b>-</b>	-

**Allocation methodology for indirect costs (continued)**

	<b>First half 2009 £m</b>	<b>First half 2008 £m</b>	<b>Change %</b>	<b>Full year 2008 £m</b>
<b>Treasury funding</b>	<b>754</b>	707	<b>7</b>	1,372

Allocated to divisions:

UK Retail	(78)	(105)	(26)	(182)
UK Corporate	(134)	(96)	40	(183)
Wealth	39	(50)	-	(86)
Global Banking & Markets	164	(56)	-	(198)
Global Transaction Services	59	37	59	93
Ulster Bank	(3)	(39)	(92)	(76)
US Retail & Commercial	(37)	(58)	(36)	(91)
RBS Insurance	(18)	(17)	6	(25)
Non-Core	(746)	(323)	131	(624)

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**Average balance sheet - pro forma**

	First half 2009			First half 2008		
	Average balance £m	Interest £m	Rate %	Average Balance £m	Interest £m	Rate %
<b>Assets</b>						
Loans and advances to banks	49,484	508	2.05	51,505	1,126	4.37
Loans and advances to customers	602,236	11,698	3.88	582,765	17,434	5.98
Debt securities	124,059	2,278	3.67	72,710	1,886	5.19
Interest-earning assets - banking business	775,779	14,484	3.73	706,980	20,446	5.78
Trading business	306,304			477,634		
Non-interest earning assets	929,398			566,820		
Total assets	2,011,481			1,751,434		
<b>Liabilities</b>						
Deposits by banks	141,778	1,254	1.77	132,668	3,002	4.53
Customer accounts	365,187	2,730	1.50	393,530	7,188	3.65
Debt securities in issue	222,999	3,658	3.28	201,589	4,344	4.31
Subordinated liabilities	36,234	732	4.04	32,085	871	5.43
Internal funding of trading business	(77,925)	(431)	1.11	(112,856)	(2,273)	4.03
Interest-bearing liabilities - banking business	688,273	7,943	2.31	647,016	13,132	4.06
Trading business	352,953			510,554		
Non-interest-bearing liabilities						
- demand deposits	36,664			31,477		
- other liabilities	876,440			509,000		
Shareholders' equity	57,151			53,387		

Total liabilities and shareholders' equity	<b>2,011,481</b>	1,751,434
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## Notes:

- (1) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.
- (2) Interest-earning assets and interest-bearing liabilities exclude the Retail bancassurance assets and liabilities, in view of their distinct nature. As a result, interest income has been adjusted by £15 million (2008 - £45 million).
- (3) Changes in the fair value of interest-bearing financial instruments designated as at fair value through profit or loss are recorded in other operating income in the consolidated income statement. In the average balance sheet shown above, interest includes interest income and interest expense related to these instruments of £25 million (2008 - £146 million) and £154 million (2008 - £378 million) respectively and the average balances have been adjusted accordingly.

**Average balance sheet - pro forma (continued)**

	<b>First half 2009</b>	First half 2008
	%	%
<b>Average yields, spreads and margins of the banking business</b>		
Gross yield on interest-earning assets of banking business	<b>3.73</b>	5.78
Cost of interest-bearing liabilities of banking business	<b>(2.31)</b>	(4.06)
<b>Interest spread of banking business</b>		
Benefit from interest-free funds	<b>0.27</b>	0.35
<b>Net interest margin of banking business</b>	<b>1.69</b>	2.07
<b>Average interest rates</b>		
The Group's base rate	<b>0.79</b>	5.19
London inter-bank three month offered rates:		
- Sterling	<b>1.73</b>	5.81
- Eurodollar	<b>1.05</b>	3.02
- Euro	<b>1.66</b>	4.67

**Condensed consolidated balance sheet****at 30 June 2009 - pro forma (unaudited)**

	30 June	31 December
	2009	2008
	£m	£m
<b>Assets</b>		
Cash and balances at central banks	34,302	11,830
Net loans and advances to banks	48,624	70,728
Reverse repurchase agreements and stock borrowing	35,076	58,771
Loans and advances to banks	83,700	129,499
Net loans and advances to customers	593,277	691,976
Reverse repurchase agreements and stock borrowing	47,485	39,289
Loans and advances to customers	640,762	731,265
Debt securities	229,059	253,159
Equity shares	14,220	22,198
Settlement balances	23,244	17,812
Derivatives	555,890	991,495
Intangible assets	15,117	16,415
Property, plant and equipment	16,292	17,181
Deferred taxation	7,573	5,786
Prepayments, accrued income and other assets	20,620	21,573
Assets of disposal groups	3,666	480
<b>Total assets</b>	<b>1,644,445</b>	<b>2,218,693</b>
<b>Liabilities</b>		
Bank deposits	135,601	178,943
Repurchase agreements and stock lending	44,142	83,666
Deposits by banks	179,743	262,609
Customer deposits	415,267	460,318
Repurchase agreements and stock lending	75,015	58,143
Customer accounts	490,282	518,461
Debt securities in issue	248,710	269,458
Settlement balances and short positions	60,282	54,264
Derivatives	534,632	969,409
Accruals, deferred income and other liabilities	21,543	24,140
Retirement benefit liabilities	1,363	1,564
Deferred taxation	3,344	3,177
Insurance liabilities	7,186	7,480
Subordinated liabilities	32,106	43,678
Liabilities of disposal groups	7,465	138
<b>Total liabilities</b>	<b>1,586,656</b>	<b>2,154,378</b>
<b>Equity:</b>		
Minority interests	2,123	5,436
Owners' equity*	55,666	58,879
<b>Total equity</b>	<b>57,789</b>	<b>64,315</b>



<b>Total liabilities and equity</b>	<b>1,644,445</b>	2,218,693
*Owners' equity attributable to:		
Ordinary shareholders	<b>47,820</b>	45,525
Other equity owners	<b>7,846</b>	13,354
	<b>55,666</b>	58,879

### Overview of condensed consolidated balance sheet - pro forma

Total assets of £1,644.4 billion at 30 June 2009 were down £574.2 billion, 26%, compared with 31 December 2008.

Cash and balances at central banks were up £22.5 billion to £34.3 billion from seasonal lows.

Loans and advances to banks decreased by £45.8 billion, 35%, to £83.7 billion reflecting lower reverse repurchase agreements and stock borrowing ("reverse repos"), down by £23.7 billion, 40% to £35.1 billion, and reduced bank placings, down by £22.1 billion, 31%, to £48.6 billion largely as a result of reduced cash collateral balances in Global Banking & Markets.

Loans and advances to customers were down £90.5 billion, 12%, at £640.8 billion. Within this, reverse repos increased by 21%, £8.2 billion to £47.5 billion. Excluding reverse repos, customer lending declined by £98.7 billion, 14% to £593.3 billion or £94.4 billion, 13% before impairment provisions. This reflected reductions in Global Banking & Markets of £38.5 billion, Non-Core, £11.6 billion including £3.5 billion transfer to disposal groups in respect of the Asian businesses, UK Corporate & Commercial £3.4 billion, US Retail & Commercial, £2.8 billion, and Ulster Bank, £1.4 billion, together with the effect of exchange rate movements, £36.4 billion, following the strengthening of sterling during the first half of 2009.

Debt securities were down £24.1 billion, 10%, to £229.1 billion and equity shares decreased by £8.0 billion, 36%, to £14.2 billion, principally due to lower holdings in Global Banking & Markets.

Settlement balances rose by £5.4 billion, 30% to £23.2 billion as a result of increased customer activity.

Movements in the value of derivatives, assets and liabilities, primarily reflect reductions in interest rates and the strengthening of sterling during the first half of 2009.

Intangible assets declined by £1.3 billion, 8%, to £15.1 billion mainly due to the £0.3 billion write-down of goodwill in the Non-Core division and the effect of exchange rates.

Deferred tax assets increased £1.8 billion, 31%, to £7.6 billion principally due to carried forward trading losses.

Increases in assets and liabilities of disposal groups largely reflect the inclusion of the Asian businesses at 30 June 2009.

Deposits by banks declined by £82.9 billion, 32% to £179.7 billion. This reflected decreased repurchase agreements and stock lending ("repos"), down £39.5 billion, 47% to £44.1 billion and reduced inter-bank deposits, down £43.4 billion, 24%, to £135.6 billion principally in Global Banking & Markets, in part due to lower collateral deposits.

Customer accounts were down £28.2 billion, 5% to £490.3 billion. Within this, repos increased £16.9 billion, 29% to £75.0 billion. Excluding repos, deposits declined by £45.1 billion, 10%, to £415.3 billion primarily due to exchange rate movements, £20.2 billion, the transfer of £7.3 billion to disposal groups in respect of the Asian businesses and reductions in Global Banking & Markets, £17.6 billion.

Debt securities in issue decreased £20.7 billion, 8%, to £248.7 billion mainly as a result of movements in exchange rates together with reductions in Global Banking & Markets and Non-Core.

Settlement balances and short positions were up £6.0 billion, 11%, to £60.3 billion reflecting increased customer activity.

Accruals, deferred income and other liabilities decreased £2.6 billion, 11%, to £21.5 billion.

Subordinated liabilities were down £11.6 billion, 26%, to £32.1 billion, reflecting the redemption of £5.0 billion undated loan capital, £1.5 billion trust preferred securities and £0.9 billion dated loan capital, together with the effect of exchange rates and other adjustments.

Equity minority interests decreased by £3.3 billion, 61% to £2.1 billion. Equity withdrawals of £3.1 billion, reflecting the disposal of the investment in Bank of China attributable to minority shareholders and the redemption, in part, of certain Trust Preferred Securities, the recycling of related available-for-sale reserves to income, £0.4 billion, and dividends paid of £0.3 billion, were partially offset by attributable profits of £0.6 billion.

#### Overview of condensed consolidated balance sheet - pro forma (continued)

Owners' equity declined by £3.2 billion, 5% to £55.7 billion. The placing and open offer in April 2009 raised £5.3 billion to fund the redemption of the £5.0 billion preference shares issued to HM Treasury in December 2008. A £0.7 billion decrease in available-for-sale reserves, net of tax, the payment of other owners dividends of £0.5 billion including £0.3 billion to HM Treasury on the redemption of preference shares, the partial redemption of paid-in equity of £0.3 billion, the attributable loss for the period of £0.5 billion and exchange rate movements of £2.3 billion, were partly offset by an increase in the cash flow hedging reserve of £0.4 billion and the equity owners gain on withdrawal of minority interests, net of tax, of £0.5 billion arising from the redemption of Trust Preferred Securities.

#### Condensed consolidated statement of changes in equity

##### for the half year ended 30 June 2009 (unaudited) - pro forma

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Called-up share capital</b>			
At beginning of period	<b>9,898</b>	2,530	2,530
Ordinary shares issued in respect of rights issue	-	1,531	1,531
Ordinary shares issued in respect of capitalisation issue	-	-	101
Ordinary shares issued in respect of placing and open offers	<b>4,227</b>	-	5,728
Preference shares issued in respect of placing and open offer	-	-	5
Other shares issued during the period	-	3	3
Preference shares redeemed during the period	<b>(5)</b>	-	-
At end of period	<b>14,120</b>	4,064	9,898

<b>Paid-in equity</b>			
At beginning of period	<b>1,073</b>	1,073	1,073
Securities redeemed during the period	<b>(308)</b>	-	-
Transfer to retained earnings	<b>(200)</b>	-	-
At end of period	<b>565</b>	1,073	1,073
<b>Share premium account</b>			
At beginning of period	<b>27,471</b>	17,322	17,322
Ordinary shares issued in respect of rights issue,			
net of £246 million expenses	-	10,469	10,469
Ordinary shares issued in respect of capitalisation issue	-	-	(101)
Ordinary shares issued in respect of placing and open offer,			
net of £95 million expenses	<b>1,047</b>	-	-
Expenses of placing and open offer	-	-	(265)
Other shares issued during the year	-	46	46
Preference shares redeemed during the period	<b>(4,995)</b>	-	-
At end of period	<b>23,523</b>	27,837	27,471
<b>Merger reserve</b>			
At beginning of period	<b>10,881</b>	10,881	10,881
Placing and open offer	-	-	14,273
Transfer to retained earnings	-	-	(14,273)
At end of period	<b>10,881</b>	10,881	10,881
<b>Available-for-sale reserves</b>			
At beginning of period	<b>(3,561)</b>	1,032	1,032
Unrealised losses in the period	<b>(1,494)</b>	(1,322)	(6,808)
Realised losses in the period	<b>197</b>	60	842
Taxation	<b>592</b>	343	1,373
At end of period	<b>(4,266)</b>	113	(3,561)
<b>Cash flow hedging reserve</b>			
At beginning of period	<b>(876)</b>	(555)	(555)
Amount recognised in equity during the period	<b>415</b>	(297)	(603)
Amount transferred from equity to earnings in the period	<b>106</b>	174	198
Taxation	<b>(138)</b>	36	84
At end of period	<b>(493)</b>	(642)	(876)

**Condensed consolidated statement of changes in equity**

for the half year ended 30 June 2009 (unaudited) - pro forma (continued)

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Foreign exchange reserve</b>			
At beginning of period	<b>6,385</b>	(426)	(426)
Retranslation of net assets	<b>(2,724)</b>	1,748	11,970
Foreign currency gains/(losses) on hedges of net assets	<b>442</b>	(1,177)	(5,801)
Taxation	<b>(46)</b>	111	642
At end of period	<b>4,057</b>	256	6,385
<b>Capital redemption reserve</b>			
At beginning and end of period	<b>170</b>	170	170
<b>Retained earnings</b>			
At beginning of period	<b>7,542</b>	21,072	21,072
Loss attributable to ordinary shareholders and other equity owners	<b>(496)</b>	(612)	(23,710)
Ordinary dividends paid	<b>-</b>	(2,312)	(2,312)
Equity preference dividends paid	<b>(510)</b>	(188)	(536)
Paid-in equity dividends paid, net of tax	<b>(36)</b>	(27)	(60)
Transfer from paid-in equity	<b>200</b>	-	-
Equity owners gain on withdrawal of minority interest			
- gross	<b>629</b>	-	-
- taxation	<b>(176)</b>	-	-
Transfer from merger reserve	<b>-</b>	-	14,273
Actuarial losses recognised in retirement benefit schemes			
- gross	<b>-</b>	-	(1,807)
- taxation	<b>-</b>	-	472
Net cost of shares bought and used to satisfy share-based payments	<b>(13)</b>	(16)	(19)
Share-based payments, net of tax	<b>60</b>	51	169
At end of period	<b>7,200</b>	17,968	7,542
<b>Own shares held</b>			
At beginning of period	<b>(104)</b>	(61)	(61)
Shares purchased during the period	<b>-</b>	(39)	(64)
Shares issued under employee share schemes	<b>13</b>	17	21
At end of period	<b>(91)</b>	(83)	(104)
<b>Owners' equity at end of period</b>	<b>55,666</b>	61,637	58,879

**Condensed consolidated statement of changes in equity**

for the half year ended 30 June 2009 (unaudited) - pro forma (continued)

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Minority interests</b>			
At beginning of period	<b>5,436</b>	5,391	5,391
Currency translation adjustments and other movements	<b>(165)</b>	162	1,158
Profit/(loss) attributable to minority interests	<b>554</b>	148	412
Dividends paid	<b>(310)</b>	(137)	(285)
Losses on available-for-sale securities			
- net losses in the period	<b>(336)</b>	(353)	(1,304)
- taxation	<b>-</b>	1	1
Equity raised	<b>9</b>	810	1,071
Equity withdrawn and disposals	<b>(2,436)</b>	(214)	(1,008)
Transfer to retained earnings	<b>(629)</b>	-	-
At end of period	<b>2,123</b>	5,808	5,436
<b>Total equity at end of period</b>	<b>57,789</b>	67,445	64,315
<b>Total comprehensive income recognised in the statement of changes in equity is attributable as follows:</b>			
Equity shareholders	<b>(3,146)</b>	(936)	(23,148)
Minority interests	<b>53</b>	(42)	267
	<b>(3,093)</b>	(978)	(22,881)

## Notes to pro forma results

### 1. Basis of preparation

The pro forma financial information shows the underlying performance of the Group including the results of the ABN AMRO businesses to be retained by the Group. This information is prepared using the Group's accounting policies as referred to on page 157 and is being provided to give a better understanding of the results of the RBS operations excluding the results attributable to the other Consortium Members.

Group operating profit on a pro forma basis excludes:

- amortisation of purchased intangible assets;
- write-down of goodwill and other intangible assets;
- integration and restructuring costs;

- gain on redemption of own debt; and
- gain on sale of strategic investments.

## 2. Analysis of income and expenses

	First half 2009			First	Full
	Core	Non-Core	Total	half	2008
	£m	£m	£m	2008	2008
Fees and commissions receivable	4,031	435	4,466	4,470	8,845
Fees and commissions payable					
- banking	(980)	(111)	(1,091)	(1,090)	(2,010)
- insurance related	(187)	(73)	(260)	(202)	(401)
<b>Net fees and commissions</b>	<b>2,864</b>	<b>251</b>	<b>3,115</b>	3,178	6,434
Foreign exchange	1,575	84	1,659	953	1,940
Interest rate	2,906	(49)	2,857	1,436	1,266
Credit	864	(4,283)	(3,419)	(6,218)	(12,181)
Other	970	(23)	947	552	268
<b>Income from trading activities</b>	<b>6,315</b>	<b>(4,271)</b>	<b>2,044</b>	(3,341)	(8,829)
Operating lease and other rental income	332	330	662	845	1,469
Changes in the fair value of own debt	(60)	-	(60)	527	977
Changes in the fair value of securities and other financial assets and liabilities	(11)	(46)	(57)	(582)	(1,364)
Changes in the fair value of investment properties	(8)	(139)	(147)	(22)	(86)
Profit on sale of securities	151	(88)	63	16	113
Profit on sale of property, plant and equipment	6	19	25	85	177
Profit on sale of subsidiaries and associates	(21)	10	(11)	554	501
Life company profits/(losses)	24	-	24	(44)	(52)
Dividend income	29	9	38	50	275
Share of profits less losses of associated entities	8	(62)	(54)	5	10
Other income	(96)	(67)	(163)	18	(499)
<b>Other operating income</b>	<b>354</b>	<b>(34)</b>	<b>320</b>	1,452	1,521
<b>Non-interest income (excluding insurance premiums)</b>	<b>9,533</b>	<b>(4,054)</b>	<b>5,479</b>	1,289	(874)
<b>Insurance net premium income</b>	<b>2,217</b>	<b>440</b>	<b>2,657</b>	2,861	5,709
<b>Total non-interest income</b>	<b>11,750</b>	<b>(3,614)</b>	<b>8,136</b>	4,150	4,835

## Notes to pro forma results (continued)

## 2. Analysis of income and expenses (continued)

	First half 2009			First half 2008	Full year 2008
	Core £m	Non-Core £m	Total £m	£m	£m
Staff costs	4,401	259	4,660	4,558	7,990
Premises and equipment	1,216	15	1,231	881	2,099
Other	1,728	233	1,961	2,120	4,267
<b>Administrative expenses</b>	<b>7,345</b>	<b>507</b>	<b>7,852</b>	7,559	14,356
Depreciation and amortisation	679	202	881	834	1,832
<b>Direct expenses</b>	<b>8,024</b>	<b>709</b>	<b>8,733</b>	8,393	16,188
Indirect expenses	(279)	279	-	-	-
<b>Operating expenses</b>	<b>7,745</b>	<b>988</b>	<b>8,733</b>	8,393	16,188
General insurance	1,551	314	1,865	1,863	3,733
Bancassurance	26	-	26	64	184
<b>Insurance net claims</b>	<b>1,577</b>	<b>314</b>	<b>1,891</b>	1,927	3,917
Note:					

The data above exclude amortisation of purchased intangibles, write-down of goodwill and other intangible assets, integration and restructuring costs, gain on redemption of own debt and strategic disposals.

## 3. Loan impairment provisions

Operating loss is stated after charging loan impairment losses of £6,796 million (first half 2008 - £1,406 million; full year 2008 - £6,478 million). The balance sheet loan impairment provisions increased in the half year ended 30 June 2009 from £9,451 million to £13,773 million, and the movements thereon were:

	First half 2009			First half 2008	Full year 2008
	Core £m	Non-Core £m	Total £m	£m	£m
At beginning of period	4,905	4,546	9,451	4,956	4,956
Transfers to disposal groups	-	-	-	(147)	-

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Currency translation and other adjustments	(529)	24	(505)	72	1,023
Disposals	-	-	-	(40)	(178)
Amounts written-off	(952)	(980)	(1,932)	(1,261)	(2,897)
Recoveries of amounts previously written-off	80	60	140	138	261
Charge to the income statement	2,170	4,626	6,796	1,406	6,478
Unwind of discount	(99)	(78)	(177)	(90)	(192)

At end of period **5,575** **8,198** **13,773** 5,034 9,451  
 Provisions at 30 June 2009 include £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million) in respect of loans and advances to banks.

#### 4. Strategic disposals

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
Gain on sale of investments in:			
Bank of China (1)	<b>241</b>	-	-
Linea Directa	<b>212</b>	-	-
Tesco Personal Finance	-	-	442
	<b>453</b>	-	442

Note:

(1) Includes £359 million attributable to minority interests.

#### Notes to pro forma results (continued)

#### 5. Goodwill

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
Write-down of goodwill and other intangible assets	<b>311</b>	-	16,196

The write down of goodwill for the half year ended 30 June 2009 principally relates to ABN AMRO and NatWest goodwill allocated to non-core businesses.

#### 6. Taxation



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The credit for taxation represents differs from the tax credit computed by applying the standard UK corporation tax rate of 28% (2008 - 28.5%) as follows:

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
Profit/(loss) before tax	<b>15</b>	(726)	(8,296)
Expected tax charge/(credit) at 28% (2008 - 28.5%)	<b>4</b>	(207)	(2,364)
Unrecognised timing differences	<b>16</b>	4	274
Other non-deductible items	<b>73</b>	162	371
Non-taxable items;			
- Gain on redemption of own debt	<b>(692)</b>	-	-
- Other	<b>(176)</b>	(225)	(491)
Taxable foreign exchange movements	<b>(23)</b>	7	80
Foreign profits taxed at other rates	<b>47</b>	(22)	271
Losses in year not recognised	<b>184</b>	40	942
Other	<b>(23)</b>	-	(11)
Adjustments in respect of prior periods	<b>178</b>	(62)	(352)
Actual tax credit	<b>(412)</b>	(303)	(1,280)

**7. Minority interests**

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
Trust preferred securities	<b>45</b>	45	65
Investment in Bank of China	<b>359</b>	-	78
Sempre joint venture	<b>144</b>	96	164
ABN AMRO	<b>2</b>	(14)	91
Other	<b>4</b>	21	14
Profit attributable to minority interests	<b>554</b>	148	412

**Notes to pro forma results (continued)**

**8. Other owners' dividends**

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008

	£m	£m	£m
Non-cumulative preference shares of US\$0.01	179	136	293
Non-cumulative preference shares of €0.01	57	52	183
Non-cumulative preference shares of £1			
- issued to UK Financial Investments Limited (1)	274	-	-
- other	-	-	60
Interest on securities classified as equity, net of tax	36	27	60
	<b>546</b>	215	596

Note:

(1) Includes £50 million redemption premium on repayment of preference shares.

## 9. Earnings per share

Earnings per share have been calculated based on the following:

	<b>First half</b>	First half	Full year
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Earnings</b>			
Loss from continuing operations attributable to ordinary shareholders	<b>(984)</b>	(786)	(24,220)
Loss from discontinued operations attributable to ordinary shareholders	<b>(58)</b>	<b>(41)</b>	(86)
<b>Weighted average number of ordinary shares (millions)</b>			
In issue during the period	<b>46,719</b>	12,197	16,563
<b>Basic loss per share from continuing operations</b>	<b>(2.1p)</b>	(6.4p)	(146.2p)
Intangibles amortisation	<b>0.2p</b>	1.6p	2.1p
Write-down of goodwill and other intangible assets	<b>0.7p</b>	-	97.8p
Integration and restructuring costs	<b>1.1p</b>	1.8p	5.9p
Gain on redemption of own debt	<b>(7.3p)</b>	-	-
Strategic disposals	<b>(1.0p)</b>	-	(2.7p)
<b>Adjusted loss per share from continuing operations</b>	<b>(8.4p)</b>	(3.0p)	(43.1p)
<b>Basic loss per share from discontinued operations</b>	<b>(0.1p)</b>	(0.4p)	(0.5p)

Notes to pro forma results (continued)

**10. Segmental analysis****Analysis of divisional contribution**

The table below provides an analysis of the divisional contribution for the first half of 2009 by main income statement captions. The pro forma divisional income statements on pages 31 to 61 reflect certain presentational reallocations as described in the notes below. These do not affect the overall contribution.

	Net	Non-			Net		
	Interest	interest	Total	Operating	Insurance	Impairment	Operating
	Income	income	income	expenses	claims	losses	profit/(loss)
	£m	£m	£m	£m	£m	£m	£m
UK Retail (1)	<b>1,684</b>	<b>806</b>	<b>2,490</b>	<b>(1,587)</b>	<b>(26)</b>	<b>(824)</b>	<b>53</b>
UK Corporate	<b>1,006</b>	<b>569</b>	<b>1,575</b>	<b>(703)</b>	-	<b>(551)</b>	<b>321</b>
Wealth	<b>339</b>	<b>225</b>	<b>564</b>	<b>(324)</b>	-	<b>(22)</b>	<b>218</b>
Global Banking &							
Markets (2)	<b>1,584</b>	<b>6,246</b>	<b>7,830</b>	<b>(2,720)</b>	-	<b>(237)</b>	<b>4,873</b>
Global Transaction							
Services	<b>446</b>	<b>782</b>	<b>1,228</b>	<b>(719)</b>	-	<b>(13)</b>	<b>496</b>
Ulster Bank	<b>410</b>	<b>108</b>	<b>518</b>	<b>(369)</b>	-	<b>(157)</b>	<b>(8)</b>
US Retail &							
Commercial	<b>942</b>	<b>504</b>	<b>1,446</b>	<b>(1,128)</b>	-	<b>(369)</b>	<b>(51)</b>
RBS Insurance	<b>182</b>	<b>1,983</b>	<b>2,165</b>	<b>(391)</b>	<b>(1,551)</b>	<b>(6)</b>	<b>217</b>
Central items	<b>(388)</b>	<b>365</b>	<b>(23)</b>	<b>196</b>	-	<b>2</b>	<b>175</b>
Core	<b>6,205</b>	<b>11,588</b>	<b>17,793</b>	<b>(7,745)</b>	<b>(1,577)</b>	<b>(2,177)</b>	<b>6,294</b>
Non-Core (3)	<b>450</b>	<b>(3,452)</b>	<b>(3,002)</b>	<b>(988)</b>	<b>(314)</b>	<b>(5,344)</b>	<b>(9,648)</b>
Amortisation of							
purchased intangible							
assets	-	-	-	<b>(140)</b>	-	-	<b>(140)</b>
Integration and							
restructuring costs	-	-	-	<b>(734)</b>	-	-	<b>(734)</b>
Gain on redemption of							
own debt	-	<b>3,790</b>	<b>3,790</b>	-	-	-	<b>3,790</b>
Strategic disposals	-	<b>453</b>	<b>453</b>	-	-	-	<b>453</b>
Write-down of							
goodwill and other							
intangible assets	-	-	-	<b>(311)</b>	-	-	<b>(311)</b>
	<b>6,655</b>	<b>12,379</b>	<b>19,034</b>	<b>(9,918)</b>	<b>(1,891)</b>	<b>(7,521)</b>	<b>(296)</b>
RFS Holdings minority							
interest	<b>1,514</b>	<b>1,293</b>	<b>2,807</b>	<b>(1,973)</b>	<b>(243)</b>	<b>(539)</b>	<b>52</b>
Total statutory	<b>8,169</b>	<b>13,672</b>	<b>21,841</b>	<b>(11,891)</b>	<b>(2,134)</b>	<b>(8,060)</b>	<b>(244)</b>

Notes:

## Notes:

- (1) reallocation of netting of bancassurance claims of £26 million from non-interest income.
- (2) reallocation of £27 million between net interest income and non-interest income in respect of funding costs of rentals assets, and to record interest on financial assets and liabilities designated as at fair value through profit or loss, £51 million.
- (3) reallocation of £140 million between net interest income and non-interest income in respect of funding costs of rental assets and to record interest on financial assets and liabilities designated as at fair value through profit or loss, £22 million.

## Notes to pro forma results (continued)

## 11. Financial instruments

## Classification

The following tables analyse the Group's financial assets and liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS39 are shown separately.

	Held-for-trading	Designated as at fair value through profit or loss	Available-for-sale	Loans and receivables	Other (amortised cost)	Finance leases	Other liabilities	Other assets/ liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>At 30 June 2009</b>									
Cash and balances at									
central banks	-	-	-	34,302	-	-	-	-	34,302
Loans & advances to banks	35,849	-	-	47,851	-	-	-	-	83,700
Loans and advances to customers	51,987	1,963	-	573,246	-	13,566	-	-	640,762

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Debt securities	107,410	4,446	105,858	11,345	-	-	-	229,059
Equity shares	9,694	1,865	2,661	-	-	-	-	14,220
Settlement balances	-	-	-	23,244	-	-	-	23,244
Derivatives (1)	555,890	-	-	-	-	-	-	555,890
Intangible assets	-	-	-	-	-	-	15,117	15,117
Property, plant and equipment	-	-	-	-	-	-	16,292	16,292
Deferred taxation	-	-	-	-	-	-	7,573	7,573
Prepayments, accrued income and other assets	-	-	-	1,461	-	-	19,159	20,620
Assets of disposal groups	-	-	-	-	-	-	3,666	3,666
<b>Total assets</b>	<b>760,830</b>	<b>8,274</b>	<b>108,519</b>	<b>691,449</b>	<b>-</b>	<b>13,566</b>	<b>61,807</b>	<b>1,644,445</b>
Deposits by banks	58,017	-	-	-	121,726	-	-	179,743
Customer accounts	64,743	4,456	-	-	421,083	-	-	490,282
Debt securities in issue	1,051	34,198	-	-	213,461	-	-	248,710
Settlement balances and short positions	37,224	-	-	-	23,058	-	-	60,282
Derivatives (1)	534,632	-	-	-	-	-	-	534,632
Accruals, deferred income and other liabilities	-	-	-	-	1,618	24	19,901	21,543
Retirement benefit liabilities	-	-	-	-	-	-	1,363	1,363
Deferred taxations	-	-	-	-	-	-	3,344	3,344
Insurance liabilities	-	-	-	-	-	-	7,186	7,186
Subordinated liabilities	-	1,291	-	-	30,815	-	-	32,106

Liabilities of disposal groups	-	-	-	-	-	-	7,465	7,465
<b>Total liabilities</b>	<b>695,667</b>	<b>39,945</b>	-	-	<b>811,761</b>	<b>24</b>	<b>39,259</b>	<b>1,586,656</b>
Equity								<b>57,789</b>
								<b>1,644,445</b>

## Notes to pro forma results (continued)

## 11. Financial instruments (continued)

## Classification (continued)

	Held-for-trading	Designated as at fair value through profit or loss	Available-for-sale	Loans and receivables	Other (amortised cost)	Finance leases	Other assets/ liabilities	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<b>At 31 December 2008</b>								
Cash and balances at central banks	-	-	-	11,830	-	-	-	11,830
Loans & advances to banks	56,234	-	-	73,265	-	-	-	129,499
Loans and advances to customers	51,501	2,141	-	663,170	-	14,453	-	731,265
Debt securities	116,159	5,294	118,722	12,984	-	-	-	253,159
Equity shares	13,314	2,075	6,809	-	-	-	-	22,198
Settlement balances	-	-	-	17,812	-	-	-	17,812
Derivatives (1)	991,495	-	-	-	-	-	-	991,495
Intangible assets	-	-	-	-	-	-	16,415	16,415

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Property, plant and equipment	-	-	-	-	-	-	-	17,181	17,181
Deferred taxation	-	-	-	-	-	-	-	5,786	5,786
Prepayments, accrued income and other assets	-	-	-	1,326	-	-	-	20,247	21,573
Assets of disposal groups	-	-	-	-	-	-	-	480	480
<b>Total assets</b>	<b>1,228,703</b>	<b>9,510</b>	<b>125,531</b>	<b>780,387</b>	<b>-</b>	<b>14,453</b>	<b>60,109</b>	<b>2,218,693</b>	
Deposits by banks	81,154	-	-	-	181,455	-	-	-	262,609
Customer accounts	55,926	4,349	-	-	458,186	-	-	-	518,461
Debt securities in issue	3,992	46,022	-	-	219,444	-	-	-	269,458
Settlement balances and short positions	42,536	-	-	-	11,728	-	-	-	54,264
Derivatives (1)	969,409	-	-	-	-	-	-	-	969,409
Accruals, deferred income and other liabilities	260	-	-	-	1,619	22	22,239	-	24,140
Retirement benefit liabilities	-	-	-	-	-	-	-	1,564	1,564
Deferred taxations	-	-	-	-	-	-	-	3,177	3,177
Insurance liabilities	-	-	-	-	-	-	-	7,480	7,480
Subordinated liabilities	-	1,410	-	-	42,268	-	-	-	43,678
Liabilities of disposal groups	-	-	-	-	-	-	-	138	138
<b>Total liabilities</b>	<b>1,153,277</b>	<b>51,781</b>	<b>-</b>	<b>-</b>	<b>914,700</b>	<b>22</b>	<b>34,598</b>	<b>2,154,378</b>	
Equity									64,315

Note:

(1) Held-for-trading derivatives include hedging derivatives

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Valuation techniques

Refer to Note 11 of the Annual Report and Accounts 2008.

#### Valuation hierarchy

The table below shows financial instruments carried at fair value by valuation method.

	30 June 2009				31 December 2008			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	(1)	(2)	(3)		(1)	(2)	(3)	
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
<b>Assets</b>								
Fair value through								
profit or loss:								
Loans and advances to banks	-	35.8	-	35.8	-	56.2	-	56.2
Loans and advances to customers	-	52.8	1.1	53.9	-	50.4	3.1	53.5
Debt securities	53.3	55.0	3.6	111.9	52.4	65.4	3.8	121.6
Equity shares	9.3	1.8	0.5	11.6	9.1	5.5	0.8	15.4
Derivatives	0.9	546.3	8.7	555.9	3.7	977.5	10.3	991.5
	<b>63.5</b>	<b>691.7</b>	<b>13.9</b>	<b>769.1</b>	<b>65.2</b>	<b>1,155.0</b>	<b>18.0</b>	<b>1,238.2</b>
Available-for-sale:								



Debt securities	<b>33.9</b>	<b>70.3</b>	<b>1.6</b>	<b>105.8</b>	18.3	97.3	3.1	118.7
Equity shares	<b>0.9</b>	<b>1.3</b>	<b>0.5</b>	<b>2.7</b>	4.6	1.9	0.3	6.8
	<b>34.8</b>	<b>71.6</b>	<b>2.1</b>	<b>108.5</b>	22.9	99.2	3.4	125.5
	<b>98.3</b>	<b>763.3</b>	<b>16.0</b>	<b>877.6</b>	88.1	1,254.2	21.4	1,363.7
<b>Liabilities</b>								
Deposits by banks and customers	-	<b>127.0</b>	<b>0.3</b>	<b>127.3</b>	-	141.1	0.3	141.4
Debt securities in issue	-	<b>32.1</b>	<b>3.1</b>	<b>35.2</b>	-	45.6	4.4	50.0
Short positions	<b>29.9</b>	<b>6.9</b>	<b>0.4</b>	<b>37.2</b>	35.4	7.1	-	42.5
Derivatives	<b>1.6</b>	<b>528.8</b>	<b>4.2</b>	<b>534.6</b>	3.5	962.0	4.0	969.5
Other financial liabilities								
(4)	-	<b>1.3</b>	-	<b>1.3</b>	-	1.3	0.3	1.6
	<b>31.5</b>	<b>696.1</b>	<b>8.0</b>	<b>735.6</b>	38.9	1,157.1	9.0	1,205.0

## Notes:

- (1) Valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares, certain exchange-traded derivatives, G10 government securities and certain US agency securities.
- (2) Valued using techniques based significantly on observable market data. Instruments in this category are valued using:
  - (a) quoted prices for identical instruments in markets which are not considered to be active or quoted prices for similar instruments trading in active or not so active markets; or
  - (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

Instruments that trade in markets that are not considered to be active, but for which valuations are based on quoted market prices, broker dealer quotations, or alternative pricing sources with reasonable levels of price transparency and instruments valued using techniques include: most government agency securities, investment-grade corporate bonds, certain mortgage products, certain bank and bridge loans, repos and reverse repos, less liquid listed equities, state and municipal obligations, most physical commodities, investment contracts issued by the Group's life assurance businesses and certain money market securities and loan commitments and most OTC derivatives.

**Notes to pro forma results** (continued)

**11. Financial instruments** (continued)

Notes (continued):

- (3) Valued using a technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used. Otherwise, the Group determines a reasonable level for the input.

Financial instruments included within level 3 of the fair value hierarchy primarily include cash instruments which trade infrequently, certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine collateralised debt obligations (CDOs), other mortgage-based products and less liquid debt securities, certain structured debt securities in issue, and OTC derivatives where valuation depends upon unobservable inputs such as certain credit and exotic derivatives. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

- (4) Comprise subordinated liabilities and write downs relating to undrawn syndicated loan facilities.

**Level 3 portfolios**

Level 3 portfolios have reduced since 31 December 2008 (by £5.4 billion) due to disposals, write downs, reclassification between levels 2 and 3 and reclassification of a number of assets from held-for-trading ('HFT') to loans and receivables ('LAR'). Level 3 liabilities have reduced by £1.0 billion.

Level 3 loans and advances to customers decreased by £2.0 billion primarily reflecting the reclassification of certain HFT loans (leveraged finance and other corporate loans) to LAR.

Debt securities categorised as level 3 at 30 June 2009 included £3.7 billion asset-backed securities and £1.5 billion of corporate and other debt securities. The decrease during the first half reflects liquidations, mark-downs and the unwinding of part of the fund derivative portfolio in the US.

Equity shares categorised as level 3 decreased by £0.3 billion primarily reflecting the movement of strategic investments from level 3 to level 2 and reduction in value of certain private equity investments, partly offset by other small increases.

Level 3 derivative assets at 30 June 2009 included credit derivative trades with credit derivative product companies ('CDPCs') with a fair value of £1.5 billion after credit valuation adjustments of £0.8 billion. At 31 December 2008 these credit derivative trades with CDPCs had a fair value of £3.5 billion after a credit valuation adjustment of £1.3 billion. Other level 3 derivative assets included illiquid credit default swaps ('CDSs'), other credit derivatives and illiquid interest rate derivatives.

Debt securities in issue, categorised as level 3 were structured medium term notes, with the decrease in the period primarily reflects the movement of £1 billion of guaranteed investment certificates from level 3 at the end of 2008 to level 2 at the end of June due to increased price availability in the market.

## Notes to pro forma results (continued)

## 11. Financial instruments (continued)

## Level 3 portfolios (continued)

	Valuation basis/technique	Main assumptions	Carrying value	Reasonably possible alternative assumptions	
			£bn	Increase in fair value £m	Decrease in fair value £m
<b>Assets</b>					
Loans and advances	Proprietary model	Credit spreads, indices	1.1	33	33
Debt securities:					
- RMBS (1)	Industry standard model	Prepayment rates, probability of default, loss severity and yield	0.4	24	28
- CMBS (2)	Industry standard model	Prepayment rates, probability of default, loss severity and yield	0.4	16	16
- CDOs (3)	Proprietary model	Implied collateral valuation, defaults rates, housing prices, correlation	1.5	311	288
- CLOs (4)	Industry standard simulation model	Credit spreads, recovery rates, correlation	0.7	27	27
- other	Proprietary model	Credit spreads	2.2	54	55
Equity shares	Private equity - valuation statements	Fund valuations	1.0	106	127
Derivatives:					
- credit	Proprietary CVA model, industry option models, correlation model	Counterparty credit risk, correlation, volatility	5.1	497	365
- other	Proprietary model	Volatility, correlation, dividends	3.6	170	174
<b>30 June 2009</b>			<b>16.0</b>	<b>1,238</b>	<b>1,113</b>
31 December 2008			21.4	1,880	2,200
<b>Liabilities</b>					
		Correlation, volatility	3.1	65	65

Debt securities in issue	Proprietary model			
Derivatives				
- credit	Proprietary CVA model, industry option models, correlation model	Correlation, volatility	2.7	196
- other	Proprietary model	Volatility, correlation	1.5	54
Other portfolios	Proprietary model	Credit spreads, correlation	0.7	11
<b>30 June 2009</b>			<b>8.0</b>	<b>326</b>
31 December 2008			9.0	490

## Notes:

- (1) Residential mortgage-backed securities.
- (2) Commercial mortgage-backed securities.
- (3) Collateralised debt obligations.
- (4) Collateralised loan obligations.

**Notes to pro forma results (continued)****11. Financial instruments (continued)****Level 3 portfolios (continued)**

For each of the portfolio categories shown in the above table, a description is set out below of the types of products that comprise the portfolio and the valuation techniques that are applied in determining fair value, and inputs to those models and techniques. These techniques are also used where the product is categorised as level 2. Where reasonably possible alternative assumptions of unobservable inputs used in models would change the fair value of the portfolio significantly, the alternative inputs are indicated along with the impact this would have on the fair value. Where there have been significant changes to valuation techniques during the year, an explanation of the reasons for this is also included. Amounts relating to 31 December 2008 are also included where relevant.

**Loans and advances to customers**

Loans in level 3 primarily comprise US commercial mortgages and syndicated loans.

Commercial mortgages

These senior and mezzanine commercial mortgages are loans secured on commercial land and buildings that were originated or acquired for securitisation. Senior commercial mortgages carry a variable interest rate and mezzanine or more junior commercial mortgages may carry a fixed or variable interest rate. Factors affecting the value of these loans may include, but are not limited to,

loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratios, prepayment rates, cumulative loan loss information, yields, investor demand, market volatility since the last securitisation, and credit enhancement. Where observable market prices for a particular loan are not available, the fair value will typically be determined with reference to observable market transactions in other loans or credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the loan and the available benchmark data. Using reasonably possible alternative assumptions for credit spreads (taking into account all other applicable factors) would reduce the fair value of these mortgages of £0.3 billion (2008 - £1.1 billion) by up to £8 million (2008 - £18 million) or increase the fair value by up to £8 million (2008 - £25 million).

#### Syndicated lending

The Group's syndicated lending activities are conducted by the syndicate business in conjunction with the loan origination business. When a commitment to lend is entered into, the Group estimates the proportion of the loan that it intends to syndicate and the proportion it anticipates to retain on its balance sheet as a loan and receivable. Where the commitment is intended to be syndicated, the commitment to lend is fair valued through the income statement. On drawdown, the portion of the loan expected to be syndicated is classified as a held-for-trading asset, and the expected hold portion is classified as loan or receivables.

The Group values the portion of the loan expected to be syndicated at fair value by using market observable syndication prices in the same or similar assets. Where these prices are not available, a discounted cash flow model is used. The model incorporates observable assumptions such as current interest rates and yield curves, the notional and tender amount of the loan, and counterparty credit quality which is derived from credit default swap spreads quoted in the market. The model also incorporates unobservable assumptions, including expected refinancing periods, and counterparty credit quality derived from the Group's internal risk assessments. Derivatives arising from commitments to lend are measured using the same model, based on proxy notional amounts.

Using reasonably possible alternative assumptions for expected cash flows to value these assets of £0.8 billion would reduce the fair value by up to £25 million (2008 - £32 million) or increase the fair value by up to £25 million (2008 - £45 million). The assumptions to determine these amounts were based on restructuring scenarios and expected margins.

#### **Notes to pro forma results (continued)**

##### Residential mortgage backed securities

RMBS where the underlying assets are US agency-backed mortgages and there is regular trading are generally classified as level 2 in the fair value hierarchy. RMBS are also classified as level 2 when regular trading is not prevalent in the market, but similar executed trades or third-party data including indices, broker quotes and pricing services can be used to substantiate the fair value. RMBS are classified as level 3 when trading data are unavailable, and in these cases a model using significant unobservable data is utilised for valuation purposes.

In determining whether an instrument is similar to that being valued, the Group considers a range of factors, principally: the lending standards of the brokers and underwriters that originated the mortgages, the lead manager of

the security, the issue date of the respective securities, the underlying asset composition (including origination date, loan-to-value ratios, historic loss information and geographic location of the mortgages), the credit rating of the instrument, and any credit protection that the instrument may benefit from, such as insurance wraps or subordinated tranches. Where there are instances of market observable data for several similar RMBS tranches, the Group considers the extent of similar characteristics shared with the instrument being valued, together with the frequency, tenor and nature of the trades that have been observed. This method is most frequently used for US and UK RMBS. The RMBS of Dutch and Spanish originated mortgages guaranteed by those governments are valued using the credit spreads of the respective government debt and certain assumptions made by the Group, or based on observable prices from Bloomberg or consensus pricing services.

Where there is no trading activity in respect of RMBS, models are used for valuation purposes. The Group primarily uses an industry standard model to project the expected future cash flows to be received from the underlying mortgages and to forecast how these cash flows will be distributed to the various holders of the RMBS. This model utilises data provided by the servicer of the underlying mortgage portfolio, layering on assumptions for mortgage prepayments, probability of default, expected losses, and yield. The Group uses data from third-party sources to calibrate its assumptions, including pricing information from third party pricing services, independent research, broker quotes, and other independent sources. An assessment is made of the third-party data source to determine its applicability and reliability. The Group adjusts the model price with a liquidity premium to reflect the price that the instrument could be traded at in the market and may also make adjustments for model deficiencies.

The weighted average of the key significant inputs utilised in valuing US level 3 RMBS positions are shown in the table below.

	Non-agency prime RMBS
	Alt-A RMBS
Yield	12%
	18%
Probability of default	3.0% CDR (1)
	40.0% CDR(1)
Loss severity	40%
	65%
Prepayment	15% CPR(2)

**11. Financial instruments (continued)**

**Level 3 portfolios (continued)**

**Debt securities**

10% CPR(2)

Notes:

(1) Constant default rate or probability of default

(2) Constant prepayment rate

**Notes to pro forma results (continued)**

**11. Financial instruments (continued)**

**Level 3 portfolios (continued)**

**Debt securities (continued)**

The fair value of securities within each class of asset changes on a broadly consistent basis in response to changes in given market factors. However, the extent of the change, and therefore the range of reasonably possible alternative assumptions, may be either more or less pronounced, depending on the particular terms and circumstances of the individual security. The Group believes that the probability of default is the least transparent input into Alt-A and prime RMBS modelled valuations and is most sensitive to variations for valuation purposes. The Group believes that a range of 500 basis points greater than and 300 basis points less than the weighted average constant default rate, and a range of 300 basis points greater than and 200 basis points less than the weighted average constant default rate represents a reasonably possible set of acceptable pricing alternatives for Alt-A and prime RMBS, respectively. These assumptions consider the inherently risky nature of Alt-A over prime securities, as well as declining economic conditions leading to an increased likelihood of default at year-end. While other key inputs may possess characteristics of unobservability in both Alt-A and prime modelled valuations, the effect of utilising reasonably possible alternatives for these inputs would have an immaterial effect on the overall valuation. Using these reasonably possible alternative assumptions the fair value of RMBS of £0.4 billion (2008 - £0.5 billion) would be £28 million (2008 - £90 million) lower or £24 million (2008 - £40 million) higher.

Commercial mortgage backed securities

CMBS are valued using an industry standard model and the inputs, where possible, are corroborated using observable market data.

For senior CMBS and subordinated tranches, the Group has determined that the most sensitive input to reasonably possible alternative valuation is probability of default and yield respectively. Using reasonably possible alternative assumptions for these inputs, the fair value of CMBS of £0.4 billion (2008 - £0.6 billion) would be £16 million (2008 - £30 million) lower or £16 million (2008 -

£30 million) higher.

#### Collateralised debt obligations

CDOs purchased from third parties are valued using independent, third-party quotes or independent lead manager indicative prices. For super senior CDOs which have been originated by the Group no specific third-party information is available. The valuation of these super senior CDOs therefore takes into consideration available market data and appropriate valuation adjustments.

A collateral net asset value methodology is considered which uses dealer buy side marks to determine an upper bound for super senior CDO valuations. An ABS index implied collateral valuation methodology is also used, which provides a market calibrated valuation data point. Both the ABS index implied valuation and the collateral net asset value methodology apply an assumed immediate liquidation approach.

The output from using these alternative assumptions has been compared with inferred pricing from other published data. The Group believes that reasonably possible alternative assumptions could reduce or increase valuations by up to 4%. Using these alternative assumptions would reduce the fair value of level 3 CDOs of £1.5 billion (2008 - £1.7 billion) by up to £288 million (2008 - £440 million) (super senior CDOs: £179 million (2008 - £292 million)) and increase the fair value by up to £311 million (2008 - £410 million) (super senior CDOs: £202 million (2008 - £292 million)).

### **Notes to pro forma results (continued)**

#### **11. Financial instruments (continued)**

##### **Level 3 portfolios (continued)**

##### **Debt securities (continued)**

#### Collateralised loan obligations

To determine the fair value of CLOs purchased from third parties, the Group uses third-party broker or lead manager quotes as the primary pricing source. These quotes are benchmarked to consensus pricing sources where they are available.

For CLOs originated and still held by the Group, the fair value is determined using a correlation model based on a Monte Carlo simulation framework. The main model inputs are credit spreads and recovery rates of the underlying assets and their correlation. A credit curve is assigned to each underlying asset based on prices, from third-party dealer quotes, and cash flow profiles, sourced from an industry standard model. Losses are calculated taking into account the attachment and detachment point of the exposure. As the correlation inputs to this model are not observable CLOs are deemed to be level 3. Using reasonably possible alternative assumptions the fair value of CLOs of £0.7 billion (2008 - £1.0 billion) would be £27 million (2008 - £40 million) lower or £27 million higher (2008 - £40 million).

#### Other debt securities



Other level 3 debt securities comprise £0.7 billion (2008 - £1.4 billion) of other asset-backed securities ('ABS') and £1.5 billion (2008 - £1.7 billion) of other debt securities. Where observable market prices for a particular debt security are not available, the fair value is typically determined with reference to observable market transactions in other related products, such as similar debt securities or credit derivatives. Assumptions are made about the relationship between the individual debt security and the available benchmark data. Where significant management judgement has been applied in identifying the most relevant related product, or in determining the relationship between the related product and the instrument itself, the valuation is shown in level 3. Using differing assumptions about this relationship would result in different fair values for these assets. The main assumption made is that of relative creditworthiness. Using reasonably possible alternative credit assumptions, taking into account the underlying currency, tenor, and rating of the debt securities within each portfolio, would reduce the fair value of other debt securities of £2.2 billion (2008 - £3.1 billion) by up to £55 million (2008 - £50 million) or increase the fair value by up to £54 million (2008 - £50 million).

### **Equity shares**

Private equity investments include unit holdings and limited partnership interests primarily in corporate private equity funds, debt funds and fund of hedge funds. Externally managed funds are valued using recent prices where available. Where not available, the fair value of investments in externally managed funds is generally determined using statements or other information provided by the fund managers.

Although such valuations are provided from third parties, the Group recognises that such valuations may rely significantly on the judgements and estimates made by those fund managers, particularly in assessing private equity components. Following the decline in liquidity in world markets, the Group believes that there is sufficient subjectivity in such valuations to report them in level 3.

Reasonably possible alternative valuations have been determined based on the historical trends in valuations received, and by considering the possible impact of market movements towards the end of the reporting period, which may not be fully reflected in valuations received. Using these reasonably possible alternate assumptions would reduce the fair value of externally managed funds of £1.0 billion (2008 - £1.1 billion) by up to £127 million (2008 - £150 million) or increase the fair value by up to £106 million (2008 - £80 million).

## **Notes to pro forma results (continued)**

### **11. Financial instruments (continued)**

#### **Level 3 portfolios (continued)**

##### **Derivatives**

Level 3 derivative assets comprise credit derivatives £5.1 billion (2008 - £8 billion), and interest rate, foreign exchange rate and commodity derivative contracts of £3.6 billion (2008 - £2.2 billion). Derivative liabilities comprise credit derivatives of £2.7 billion (2008 - £2.6 billion), and interest rate, foreign exchange rate and commodity derivatives contracts of £1.5 billion (2008 - £1.4

billion).

Derivatives are priced using quoted prices for the same or similar instruments where these are available. However, the majority of derivatives are valued using pricing models. Inputs for these models are usually observed directly in the market, or derived from observed prices. However, it is not always possible to observe or corroborate all model inputs. Where there are no observable inputs in respect of certain or all of the parameters, inputs are based on estimates taking into account a range of available information including historical analysis, historical traded levels, market practice, comparison to other relevant benchmark observable data and consensus pricing data.

#### Credit derivatives

The Group's credit derivatives include vanilla and bespoke portfolio tranches, gap risk products and certain other unique trades. The bespoke portfolio tranches are synthetic tranches referenced to a bespoke portfolio of corporate names on which the Group purchases credit protection. Bespoke portfolio tranches are valued using Gaussian Copula, a standard method which uses observable market inputs (credit spreads, index tranche prices and recovery rates) to generate an output price for the tranche via a mapping methodology. In essence this method takes the expected loss of the tranche expressed as a fraction of the expected loss of the whole underlying portfolio and calculates which detachment point on the liquid index, and hence which correlation level, coincides with this expected loss fraction. Where the inputs into this valuation technique are observable in the market, bespoke tranches are considered to be level 2 assets. Where inputs are not observable, bespoke tranches are considered to be level 3 assets. However, all transactions executed with CDPCs are considered level 3 as the counterparty credit risk assessment is a significant component of these valuations.

Gap risk products are leveraged trades, with the counterparty's potential loss capped at the amount of the initial principal invested. Gap risk is the probability that the market will move discontinuously too quickly to exit a portfolio and return the principal to the counterparty without incurring losses, should an unwind event be triggered. This optionality is embedded within these portfolio structures and is very rarely traded outright in the market. Gap risk is not observable in the markets and, as such, these structures are deemed to be level 3 instruments.

Other unique trades are valued using a specialised model for each instrument with the same market data inputs as all other trades where applicable. By their nature, the valuation is also driven by a variety of other model inputs, many of which are unobservable in the market. Where these instruments have embedded optionality it is valued using a variation of the Black-Scholes option pricing formula, and where they have correlation exposure it is valued using a variant of the Gaussian Copula model. The volatility or unique correlation inputs required to value these products are generally unobservable and the instruments are therefore deemed to be level 3 instruments.

**Notes to pro forma results** (continued)

## **11. Financial instruments** (continued)

### **Level 3 portfolios (continued)**

#### **Derivatives (continued)**

##### Equity derivatives

Equity derivative products are split into equity exotic derivatives and equity hybrids. Equity exotic derivatives have payouts based on the performance of one or more stocks, equity funds or indices. Most payouts are based on the performance of a single asset and are valued using observable market option data. Unobservable equity derivative trades are typically complex basket options on stocks. Such basket option payouts depend on the performance of more than one equity asset and require inputs based on the correlations between the individual components of the stock market. Valuation is then performed using industry standard valuation models, with unobservable correlation inputs calculated by reference to correlations observed between similar underlying instruments.

Equity hybrids have payouts based on the performance of a basket of underlying instruments where the underlying instruments are all from different asset classes. Correlations between these different underlying instruments are typically unobservable with no market information for closely related assets available. Where no market for the correlation input exists, these inputs are based on historical time series.

For equity exotic derivatives and equity hybrids, reasonable possible alternative valuations are determined on the basis of parameter uncertainty calculations for the unobservable parameters. The range of valuations is inferred from consensus data and market quotes. Where day one reserves exist for a given product, the worst case valuation is mitigated by these reserves. For certain products, day one reserves exceed valuation uncertainty and in these instances the worst case is deemed to be current book value.

##### Other derivatives

Interest rate and commodity options provide a payout (or series of payouts) linked to the performance of one or more underlying rates, including interest rates, foreign exchange rates and commodity prices. Included in commodities derivatives are energy contracts entered into by RBS Sempra Commodities. Most of these contracts are valued using models that incorporate observable data. A small number are more complex, structured derivatives which incorporate in their valuation assumptions regarding power price volatilities and correlation between inputs, which are not market observable. These include certain tolling agreements, where power is purchased in return for a given quantity of fuel, and load deals, where a seller agrees to deliver a fixed proportion of power used by a client's utility customers.

Exotic options do not trade in active markets except in a small number of cases. Consequently, the Group uses models to determine fair value using valuation techniques typical for the industry. These techniques can be divided, firstly, into modelling approaches and, secondly, into methods of assessing appropriate levels for model inputs. The Group uses a variety of proprietary models for valuing exotic trades.

Exotic valuation inputs include correlation between interest rates, foreign exchange rates and commodity prices. Correlations for more liquid rate pairs are valued using independently sourced consensus pricing levels. Where a consensus pricing benchmark is unavailable, these instruments are categorised as level 3.

Reasonably possible alternative assumptions have been determined by stressing unobservable model input parameters by levels determined by a qualitative assessment of historical data.

**Notes to pro forma results** (continued)

**11. Financial instruments** (continued)

**Level 3 portfolios** (continued)

**Derivatives** (continued)

*Reasonably possible alternative assumptions for derivatives*

In determining the effect of reasonably possible alternative assumptions for unobservable inputs, the Group has considered credit derivative trades with CDPCs separately from all other level 3 derivatives due to the significant element of subjectivity in determining the counterparty credit risk.

The fair value of credit derivative trades with CDPCs as at 30 June 2009 was £2.3 billion (2008 - £4.8 billion) before applying a CVA of £0.8 billion (2008 - £1.3 billion). The Group's credit derivative exposures to CDPCs are valued using pricing models with inputs observed directly in the market. An adjustment is made to the model valuation as the creditworthiness of CDPCs differs from that of the credit risk assumptions used in the model. The adjustment reflects the estimated cost of hedging the counterparty risk arising from each trade. In the absence of market observable credit spreads of CDPCs, the cost of hedging the counterparty risk is estimated from an analysis of the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle. A reasonably possible alternative approach would be to estimate the cost of hedging the counterparty risk from market observable credit spreads of entities considered similar to CDPCs (for example monoline insurers with similar business or similarly rated entities). These reasonably possible alternative approaches would reduce the fair value credit derivatives with CDPCs by up to £111 million (2008 - £740 million) or increase the fair value by up to £245 million (2008 - £600 million).

For all other level 3 derivatives, unobservable inputs are principally comprised of correlations and volatilities. Where a derivative valuation relies significantly on an unobservable input, the valuation is shown in level 3. It is usual for such derivative valuations to depend on several observable, and one or few unobservable model inputs. In determining reasonably possible alternative assumptions, the relative effect of unobservable inputs compared to those which may be observed was considered. Using reasonably possible alternative assumptions the fair value of all other level 3 derivative assets (excluding CDPCs) would be reduced by up to £428 million (2008 - £600 million) or increased by up to £422 million (2008 - £560 million), and derivative liabilities of £4.2 billion (2008 - £4.0 billion) would be reduced by up to £248 million (2008 - £300 million) or increased by up to £250 million (2008 - £280 million).

**Other financial instruments**

The carrying value of debt securities in issue is represented partly by underlying cash and partly through a derivative component. The classification of the amount in level 3 is driven by the

derivative component and not by assumptions.

In addition to the portfolios discussed above, there are other financial instruments which are held at fair value determined from data that are not market observable, or incorporating material adjustments to market observed data. Using reasonably possible alternate assumptions appropriate to the liability in question, such as credit spreads, derivative inputs and equity correlations, would reduce the fair value of other financial instruments held at fair value of £3.5 billion (2008 - £5.0 billion), primarily debt securities in issue of £3.1 billion (2008 - £4.4 billion), by up to £76 million (2008 - £250 million) or increase the fair value by up to £76 million (2008 - £210 million).

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Own credit

When valuing financial liabilities recorded at fair value, the Group takes into account the effect of its own credit standing. The categories of financial liabilities on which own credit spread adjustments are made are issued debt, including issued structured notes, and derivatives. An own credit adjustment is applied to positions where it is believed that counterparties would consider the Group's creditworthiness when pricing trades.

For issued debt and structured notes, this adjustment is based on independent quotes from market participants for the debt issuance spreads above average inter-bank rates (at a range of tenors) which the market would demand when purchasing new senior or sub-debt issuances from the Group. Where necessary, these quotes are interpolated using a curve shape derived from CDS prices.

The fair value of the Group's derivative financial liabilities has also been adjusted to reflect the Group's own credit risk. The adjustment takes into account collateral posted by the Group and the effects of master netting agreements.

The table below shows the own credit spread adjustments on liabilities recorded in the income statement during the first half of the year.

	<b>Debt securities in issue</b>				
	<b>Designated</b>				
	<b>at fair value</b>				
	<b>through</b>				
	<b>profit and</b>				
	<b>Held-for-trading</b>	<b>loss</b>	<b>Total</b>	<b>Derivatives</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
At 1 January 2009	1,346	1,027	2,373	450	2,823
Net effect of changes to credit spreads	242	(73)	169	54	223
Foreign exchange movements	(189)	(31)	(220)	-	(220)
New issues and redemptions (net)	(22)	11	(11)	-	(11)

At 30 June 2009	<b>1,377</b>	<b>934</b>	<b>2,311</b>	<b>504</b>	<b>2,815</b>
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The effect of change in credit spreads could be reversed in future periods.

### Reclassification of financial instruments

During 2008, as permitted by amended IAS 39, the Group reclassified financial assets from the held-for-trading and available-for-sale categories into the loans and receivables category and from the held-for-trading category into the available-for-sale category.. There were further reclassifications from the held-for-trading category to the loans and receivables category in the first half of 2009. The effect of the reclassifications and the balance sheet values of the assets were as follows.

	Additional losses that would have been recognised in H1 2009 if reclassifications had not occurred		
	Total £m	Reclassified in: <b>H1 2009</b> £m	2008 £m
From held-for-trading to:			
Available-for-sale	(284)	-	(284)
Loans and receivables	526	<b>178</b>	348
Total	242	<b>178</b>	64

## Notes to pro forma results (continued)

### 11. Financial instruments (continued)

#### Reclassification of financial instruments (continued)

	Assets reclassified in 2009 carrying value £m	30 June 2009		31 December 2008	
		All reclassifications Carrying value £m	Fair value £m	All reclassifications (1) Carrying value £m	Fair value £m
From held-for-trading to:					
Available-for-sale	-	<b>8,442</b>	<b>8,442</b>	12,047	12,047

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Loans and receivables	<b>1,871</b>	<b>16,458</b>	<b>12,158</b>	20,774	16,628
	<b>1,871</b>	<b>24,900</b>	<b>20,600</b>	32,821	28,675
From available-for-sale to:					
Loans and receivables	-	<b>866</b>	<b>741</b>	1,016	956
	<b>1,871</b>	<b>25,766</b>	<b>21,341</b>	33,837	29,631

Note:

(1) 31 December 2008 amounts have been restated.

During the period, the balance sheet value of reclassified assets reduced by £8.1 billion. This was primarily due to disposals and repayments of £6.0 billion across a range of asset backed securities and loans, foreign exchange rate movements of £3.2 billion and impairment losses of £1.5 billion offset by reclassifications in the period of £1.9 billion.

For assets reclassified from held-for-trading to available-for-sale, net unrealised losses recorded in equity at 30 June 2009 were £1.9 billion (31 December 2008 - £2.2 billion).

## 12. Debt securities

	<b>UK central and local government</b>	<b>US central and local government</b>	<b>Other central and local government</b>	<b>Bank and building society</b>	<b>Asset backed securities</b>	<b>Corporate</b>	<b>Other</b>	<b>Total</b>
<b>30 June 2009</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Held-for-trading	7,753	9,526	43,289	5,079	32,539	8,266	958	107,410
Designated as at fair value through profit or loss	1,943	3	439	624	354	1,074	9	4,446
Available-for-sale	5,401	9,616	26,727	7,800	48,817	7,010	487	105,858
Loans and receivables	-	-	31	97	8,746	2,416	55	11,345
	<b>15,097</b>	<b>19,145</b>	<b>70,486</b>	<b>13,600</b>	<b>90,456</b>	<b>18,766</b>	<b>1,509</b>	<b>229,059</b>
31 December 2008								
Held-for-trading	5,373	9,858	37,519	4,333	39,879	17,627	1,570	116,159
Designated as at fair value through profit or loss	2,085	510	456	-	236	1,551	456	5,294
Available-for-sale	11,330	6,145	21,735	10,549	62,067	5,689	1,207	118,722
Loans and receivables	-	-	-	114	8,961	3,749	160	12,984

18,788      16,513      59,710    14,996    111,143      28,616    3,393    253,159

### Notes to pro forma results (continued)

#### 13. Derivatives

	30 June 2009		31 December 2008	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
<b>Exchange rate contracts</b>				
Spot, forwards and futures	29,060	28,178	82,963	83,433
Currency swaps	32,678	30,841	53,231	54,413
Options purchased	18,384	-	36,688	-
Options written	-	17,908	-	34,946
<b>Interest rate contracts</b>				
Interest rate swaps	330,175	316,416	547,566	530,843
Options purchased	61,058	-	99,176	-
Options written	-	60,122	-	102,210
Futures and forwards	3,635	2,836	7,600	6,620
<b>Credit derivatives</b>	64,382	59,715	142,367	132,734
<b>Equity and commodity contracts</b>	16,518	18,616	21,904	24,210
	<b>555,890</b>	<b>534,632</b>	991,495	969,409

Note: of the total above at 30 June 2009, £30.5 billion assets and £27.9 billion of liabilities relate to non core.

The Group enters into master netting agreements in respect of its derivatives activities. These arrangements, which give the Group a legal right to set-off derivative assets and liabilities with the same counterparty, do not result in a net presentation in the Group's balance sheet for which IFRS requires an intention to settle net or to realise the asset and settle the liability simultaneously as well as a legally enforceable right to set off. They are, however, effective in reducing the Group's credit exposure from derivative assets. The Group has executed master netting agreements with the majority of its derivative counterparties resulting in a significant reduction in its net exposure to derivative assets. Of the £556 billion derivatives assets shown above, £461 billion (31 December 2008 - £834 billion) were under such agreements. Furthermore, the Group holds substantial collateral against this net derivative asset exposure.

#### 14. Analysis of contingent liabilities and commitments

30 June 2009	31 December	30 June 2008
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				2008	
	Core £m	Non-Core £m	Total £m	£m	£m
<b>Contingent liabilities</b>					
Guarantees and assets pledged as collateral security	37,214	859	38,073	45,931	40,445
Other contingent liabilities	15,161	891	16,052	21,765	16,063
	<b>52,375</b>	<b>1,750</b>	<b>54,125</b>	67,696	56,508
<b>Commitments</b>					
Undrawn formal standby facilities, credit lines and other					
commitments to lend	266,013	30,571	296,584	349,416	316,090
Other commitments	4,148	34	4,182	6,876	3,361
	<b>270,161</b>	<b>30,605</b>	<b>300,766</b>	356,292	319,451
Total contingent liabilities and commitments	<b>322,536</b>	<b>32,355</b>	<b>354,891</b>	423,988	375,959

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material loss will arise from these transactions.

### Independent review report to The Royal Bank of Scotland Group plc

We have been engaged by the company to review the pro forma financial information in the half yearly financial report for the six months ended 30 June 2008, the year ended 31 December 2008 and the six months ended 30 June 2009 which comprises the pro forma summary consolidated income statement, the pro forma condensed consolidated balance sheet, the pro forma condensed consolidated statement of changes in equity, the pro forma divisional performance disclosures, the related notes 1 to 14 on pro forma results and parts of Risk and capital management set out on pages 96, 105 to 115 and 118 to 144 (together "the pro forma financial information").

This report is made solely to the company in accordance with the International Standard on Review Engagements 2410 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

### Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the pro forma financial information in accordance with the basis of preparation described in note 1 on page 72.

### Our responsibility

Our responsibility is to express to the company a conclusion on the pro forma financial information in the half-yearly financial report based on our review.

### **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review we are not aware of any material modifications that should be made to the pro forma financial information for the six months ended 30 June 2009, year ended 31 December 2008 or six months ended 30 June 2008.

Deloitte LLP

Chartered Accountants and Statutory Auditors  
Edinburgh, United Kingdom

6 August 2009

### **Risk and capital management**

Risk and capital management across the Group is based on the risk appetite set by the Board, which sets strategic direction, contributes to, and ultimately approves annual plans for each division, and regularly reviews and monitors the Group's performance in relation to risk through monthly Board reports.

### **Commentary and outlook**

Whilst the future for many aspects of the global economy remains uncertain, it is clear that the first half of 2009 saw a decisive shift. The extreme volatility and risk aversion that characterised the end of 2008 moderated and equity and fixed income markets largely recovered value lost at the start of the year in a sustained rally that ran for most of the second quarter. Intervention by governments and central banks has prevented further failure in the world's financial system. At this point in what has already been a sharp economic slowdown, the key focus is on whether a broader economic recovery can be established, limiting the recession's duration.

For RBS, as for many of its peers, it appears that the full impact of the slowdown already witnessed has yet to be fully realised in terms of loan impairments. This is true for both retail portfolios, where unemployment is likely to rise further even if the broader economy stabilises, and corporate portfolios, where default rates have yet to peak. The Group's investment in remedial and collection processes is therefore of major importance. The Group is committed to working with its customers to restructure debt and aid recovery wherever possible; doing so both maximises current value and supports the Group's franchises in the longer term.

As importantly, this approach drives a focus on early identification and intervention in portfolios most exposed to economic weakness. Responsibility for this rests with the Group's businesses and functions across the Group; the Group's risk management teams continue to work closely with customer and product groups to identify vulnerable

customers or portfolio segments and to implement mitigation strategies.

Recovery from a slowdown as sharp as that recently experienced, especially as it will involve the correction of material imbalances in the global economy, is likely to be accompanied by periods of volatility. Whilst not anticipating a return to the extreme uncertainty and market dislocation witnessed during the past two years, a return to the extended period of extreme stability that preceded them is also not expected. The Group's profile - in both its core and non-core activities - remains such that events in many of the world's geographies and markets have the potential to impact the Group's performance.

Effective risk management is therefore of strategic importance for RBS and refinements to the Group's risk management framework continue to be implemented. Updated limit frameworks for both credit and market risk support strategic priorities by targeting resources on areas that are core to the Group's future success. The Group will continue to invest in people, both through recruitment and development, at all levels in the risk management organisation. Through these and other changes, the risk management framework and function are being developed to support the Group's execution against its strategic plan.

## **Risk and capital management** (continued)

### **Risk governance**

Risk and capital management strategy is owned and set by the Group's Board of Directors, and implemented by executive management led by the Group Chief Executive. There are a number of committees and executives that support the execution of the business plan and strategy.

Refer to the Annual Report and Accounts 2008 for further information on the risk and capital management strategy, noting the following changes:

- The Group Executive Management Committee has been replaced by the Executive Committee;
- As a result of the Group adopting a new credit approval framework based on delegated individual authority, a new forum - the Executive Credit Group - was formed to consider, on behalf of the Board of Directors, credit applications that exceed the highest level of individual authority provided by the framework; and
- The Group Chief Executive's Advisory Group (GCEAG) has been disbanded and its responsibilities assigned to other fora. Executive Committee and Management Committee members now meet twice weekly. The risk management scope of the GCEAG has been incorporated into the agenda of the Executive Risk Forum.

### **Presentation of information**

The information in this section has been prepared on a pro forma basis (Group before RFS minority interests) unless otherwise indicated as prepared on a statutory basis.

**Risk and capital management** (continued)**Capital**

The Group aims to maintain appropriate levels of capital. For details on capital adequacy, refer to the Annual Report and Accounts 2008.

**Capital resources and ratios**

The Group's regulatory capital resources on a proportional consolidation basis excluding RFS minority interest at 30 June 2009, in accordance with Financial Services Authority (FSA) definitions, were as follows:

	<b>30 June</b>	31 December	30 June
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Capital base</b>			
Core Tier 1 capital: ordinary shareholders' funds and minority interests			
less intangibles	<b>35,177</b>	34,041	26,097
Preference shares and tax deductible securities	<b>13,949</b>	23,091	16,200
Tax on the excess of expected losses over provisions	<b>599</b>	308	437
Less deductions from Tier 1 capital	<b>(329)</b>	(316)	(218)
Tier 1 capital	<b>49,396</b>	57,124	42,516
Tier 2 capital	<b>18,879</b>	28,967	25,966
Tier 3 capital	<b>232</b>	260	215
	<b>68,507</b>	86,351	68,697
Less: Supervisory deductions	<b>(4,536)</b>	(4,155)	(4,157)
Total regulatory capital	<b>63,971</b>	82,196	64,540
<b>Risk-weighted (or equivalent risk-weighted) assets</b>			
Credit risk	<b>404,100</b>	433,400	385,000
Counterparty risk	<b>53,000</b>	61,100	37,100
Market risk	<b>56,300</b>	46,500	32,500
Operational risk	<b>33,900</b>	36,800	37,100
	<b>547,300</b>	577,800	491,700
<b>Risk asset ratio</b>			
Core Tier 1	<b>6.4%</b>	5.9%	5.3%
Tier 1	<b>9.0%</b>	9.9%	8.6%
Total	<b>11.7%</b>	14.2%	13.1%

**Risk asset ratio (statutory basis)**

Core Tier 1	<b>7.0%</b>	6.6%	6.5%
Tier 1	<b>9.3%</b>	10.0%	9.1%
Total	<b>11.9%</b>	14.1%	13.2%

**Risk and capital management** (continued)**Capital resources and ratios** (continued)

The components of the Group's regulatory capital resources at 30 June 2009 in accordance with FSA definitions were as follows:

	<b>30 June</b>	31 December	30 June
	<b>2009</b>	2008	2008
	<b>£m</b>	£m	£m
<b>Composition of regulatory capital</b>			
<b>Tier 1</b>			
Ordinary shareholders' equity	<b>47,820</b>	45,525	53,283
Minority interests	<b>2,123</b>	5,436	5,808
Adjustments for:			
Goodwill and other intangible assets - continuing	<b>(15,117)</b>	(16,386)	(27,534)
Goodwill and other intangibles assets - discontinued	-	-	(47)
Unrealised losses on available-for-sale debt securities	<b>4,194</b>	3,687	919
Reserves arising on revaluation of property and unrealised gains on			
available-for-sale equities	<b>(25)</b>	(984)	(2,623)
Reallocation of preference shares and innovative securities	<b>(656)</b>	(1,813)	(1,813)
Other regulatory adjustments	<b>(263)</b>	9	(37)
Less expected losses over provisions net of tax	<b>(1,502)</b>	(770)	(1,095)
Less securitisation positions	<b>(1,397)</b>	(663)	(764)
Core Tier 1 capital	<b>35,177</b>	34,041	26,097
Preference shares	<b>11,207</b>	16,655	10,608
Innovative Tier 1 securities	<b>2,742</b>	6,436	5,592
Tax on the excess of expected losses over provisions	<b>599</b>	308	437
Less deductions from Tier 1 capital	<b>(329)</b>	(316)	(218)
Total Tier 1 capital	<b>49,396</b>	57,124	42,516
<b>Tier 2</b>			
Reserves arising on revaluation of property and unrealised gains on			
available-for-sale equities	<b>25</b>	984	2,623
Collective impairment allowances	<b>744</b>	666	326
Perpetual subordinated debt	<b>4,094</b>	9,079	8,419
Term subordinated debt	<b>17,832</b>	20,282	17,012

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Minority and other interests in Tier 2 capital	<b>11</b>	11	100
Less deductions from Tier 2 capital	<b>(3,827)</b>	(2,055)	(2,514)
Total Tier 2 capital	<b>18,879</b>	28,967	25,966
<b>Tier 3</b>	<b>232</b>	260	215
<b>Supervisory deductions</b>			
Unconsolidated investments	<b>4,461</b>	4,044	4,119
Other deductions	<b>75</b>	111	38
Total deductions other than from Tier 1 capital	<b>4,536</b>	4,155	4,157
<b>Total regulatory capital</b>	<b>63,971</b>	82,196	64,540

**Risk and capital management** (continued)

**Credit risk**

Key elements of the Group's credit risk management framework are laid out in the Annual Report & Accounts 2008. Key developments in the first half of 2009 were:

- The introduction of a new credit approval framework for wholesale credit, replacing credit committees with individual delegated authorities and requiring at least two individuals to approve each credit decision, one from the business and one from risk management. Both parties must hold sufficient delegated authority. The level of authority granted to an individual is dependent on their experience and expertise with only a small number of senior executives holding the highest authority provided under the framework.
- Further refinement and embedding of the frameworks to manage the various dimensions of concentration risk: country, sector and single name.

**Credit risk assets**

Credit risk assets consist of loans and advances (including overdraft facilities), instalment credit, finance lease receivables and other traded instruments across all customer types. Reverse repurchase agreements and issuer risk are excluded.

**30 June**

**2009**  
**£bn**

UK Retail	98
UK Corporate	100
Wealth	14
Global Banking & Markets	264
Global Transaction Services	7
Ulster Bank	40
US Retail and Commercial	56
RBS Insurance	3
Other	-
Core	582
Non-core	156
	738

Total credit risk assets fell 14% to £738 billion at 30 June 2009, largely owing to a reduction in loans and advances to customers and banks and to the impact of sterling strengthening during the first half of the year. In the UK, credit risk assets fell only 1% while outside the UK the reduction was 22%.

## Risk and capital management (continued)

### Credit risk (continued)

#### Credit concentration risk (including country risk)

The country risk table below shows credit risk assets exceeding £1 billion by borrower domicile for countries designated internally as risk countries. Exposure is stated gross of mitigating action which may have been taken to reduce or eliminate exposure to country risk events.

	30 June 2009				31 December 2008			
	Consumer £m	Banks, financial institutions and sovereign	Corporate £m	Total £m	Consumer £m	Banks, financial institutions and sovereign	Corporate £m	Total £m
UAE	596	1,647	2,733	4,976	757	1,813	2,989	5,559
India	970	906	3,047	4,923	1,020	743	3,801	5,564
Russia	91	290	3,305	3,686	51	362	5,361	5,774
Turkey	12	926	2,192	3,130	25	966	3,036	4,027
China	22	1,477	1,473	2,972	25	1,207	2,027	3,259
South Korea	1	1,339	1,004	2,344	2	1,743	1,104	2,849
Taiwan	995	589	558	2,142	1,019	1,394	825	3,238
Romania	512	478	836	1,826	584	305	917	1,806
Mexico	1	234	1,589	1,824	4	268	2,000	2,272

Czech Republic	2	697	818	1,517	2	769	1,058	1,829
Kazakhstan	48	495	661	1,204	70	917	859	1,846
Brazil	3	713	457	1,173	4	1,012	642	1,658
Poland	6	178	983	1,167	7	347	1,309	1,663
Hungary	4	79	1,078	1,161	5	176	831	1,012
South Africa	33	543	452	1,028	27	361	507	895
Saudi Arabia	23	392	597	1,012	23	536	679	1,238

Note:

- (1) Risk countries are defined as those with an internal rating of A+ and below. In addition, United Arab Emirates is included which has a rating of AA.

The outlook for developing markets has improved but remains challenging in line with global trends. Sovereigns are more resilient than during previous downturns, but the collapse in world trade resulted in a severe growth shock across all regions in the first half of 2009. Although most economies have now stabilised and are showing tentative signs of recovery, prospects vary and significant risks remain. Asia is still growing and best placed to rebound as sovereigns continue to provide strong fiscal stimulus, however, growth will remain below trend as export dependency is reduced only slowly. Middle East governments remain strong, but corporates have been hit by the real estate correction. Latin America is reasonably resilient, but still closely linked to the US and to commodities markets. Risks are highest in some Eastern European countries owing to onerous private sector debt levels and weaker sovereign liquidity.

## Risk and capital management (continued)

### Credit risk (continued)

#### Credit risk assets by industry and geography (Core and Non-Core)

Industry analysis plays an important part in assessing potential concentration risk in the loan portfolio. Heightened monitoring applies to industry sectors where the Group believes there is a high degree of risk or potential for volatility in the future.

	30 June	31 December
	2009	2008 (1)
Credit risk assets by industry sector	£bn	£bn
Personal	184	198
Property (2)	152	180
Banks and building societies	104	113
Financial intermediaries	54	68
Transport and storage	50	59
Public sectors and quasi-government	35	42
Technology, media, telecommunications	32	35



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Wholesale and retail trade	<b>26</b>	29
Building	<b>25</b>	40
Power, water and waste	<b>20</b>	27
Natural resources and nuclear	<b>20</b>	25
Tourism and leisure	<b>18</b>	20
Business services	<b>14</b>	15
Agricultural and fisheries	<b>4</b>	4
	<b>738</b>	855

Notes:

- (1) Prior period amounts have been restated to reflect internal reclassifications of certain business lines.
- (2) Property includes direct property financing plus related exposures.

	<b>30 June</b>	31 December
<b>Credit risk assets by geography</b>	<b>2009</b>	2008
	<b>£bn</b>	£bn
United Kingdom	<b>324</b>	327
Western Europe (excluding UK)	<b>182</b>	226
North America	<b>136</b>	178
Asia & Pacific	<b>41</b>	56
Latin America	<b>24</b>	31
CEE & Central Asia	<b>17</b>	22
Middle East & Africa	<b>14</b>	15
	<b>738</b>	855

**Single name concentrations**

Some progress was made against exceptions arising from the Group's refined single name concentration framework during the first half of the year, although illiquid markets have reduced the scope for exposure management. In a number of cases, exposure has reduced, however negative rating migration has also created additional cases that exceed the framework's parameters. Overall there were fewer exceptions at the end of the period than at the beginning the number of corporate exceptions reduced from 552 to 501 while financial institution exceptions reduced from 150 to 122. Refining the framework and embedding it in core business processes remains a key focus going forward.

**Risk and capital management** (continued)

**Credit risk** (continued)

**Credit risk asset quality**

Refer to the Annual Report and Accounts 2008 and 2008 Pillar 3 Disclosure for details of the Group's credit grading framework and processes.

<b>Credit risk assets by asset quality band</b>	<b>PD range</b>	<b>30 June</b>	31 December
		<b>2009 £bn</b>	2008 £bn
AQ1	0% - 0.034%	<b>162</b>	208
AQ2	0.034% - 0.048%	<b>24</b>	30
AQ3	0.048% - 0.095%	<b>33</b>	45
AQ4	0.095% - 0.381%	<b>119</b>	159
AQ5	0.381% - 1.076%	<b>126</b>	157
AQ6	1.076% - 2.153%	<b>102</b>	107
AQ7	2.153% - 6.089%	<b>52</b>	48
AQ8	6.089% - 17.222%	<b>26</b>	26
AQ9	17.222% - 100%	<b>17</b>	12
AQ10	100%	<b>34</b>	19
Other (1)		<b>43</b>	44
		<b>738</b>	855

Notes:

(1) “Other” largely comprises assets covered by the standardised approach for which a probability of default (PD) equivalent to those assigned to assets covered by the internal ratings based approach is not available.

**Risk and capital management** (continued)**Credit risk** (continued)**Key credit portfolios** (Analysis refers to combined Core/Non-Core portfolios unless otherwise stated)

The discussions below relate to credit risk assets in specific portfolios within the Group.

**Commercial property**

The commercial property portfolio credit risk assets total £90.8 billion, an 8% decrease from the beginning of the year, split between: UK (£58.0 billion); Western Europe (£22.1 billion); North America (£6.8 billion); and other regions (£3.9 billion). As part of the strategic review, 40% of the Group's commercial property portfolio was designated Non-Core.

Lending is spread across: investment (70%); development (28%); and other (2%). Speculative lending represents less than 2% of the portfolio. The Group's appetite for originating speculative commercial property lending is limited and any such business requires exceptional approval under the credit approval framework.

The decrease in asset valuations continues to place strain on the portfolio with more clients seeking covenant renegotiations while discussing structural enhancements and/or potential equity injections. The average loan-to-value (LTV) is 89%. The average interest coverage ratios for GBM and UK Corporate portfolios are 168% and 162% respectively.

The Group's lending approach has always been predominantly cashflow driven and that has mitigated the impact of asset devaluation, however, the outlook remains challenging with further pressure on asset values expected, limited liquidity to support refinancing and increasing concerns about tenant failures. The Group is working closely with clients to restructure loans and achieve outcomes that benefit both parties. Portfolios are subject to specific monitoring within originating divisions and a separate unit has been established and staffed in the first half of 2009 to ensure that specialised expertise is deployed to actively manage this portfolio on a global and coordinated basis. 13% of the portfolio was non-performing at 30 June 2009, compared to 6% at 31 December 2008.

### **UK residential mortgages**

The UK mortgage portfolio totalled £79 billion at 30 June 2009, an increase of 6% during the first half of the year and 9% higher than June 2008, due to strong sales growth and lower redemption rates. Brands are the Royal Bank of Scotland, NatWest, the One Account, and First Active. The assets comprise prime mortgage lending and include 7% (£5.4 billion) of exposure to residential buy-to-let. There is a very small legacy self certification book (0.4% of total assets) which was withdrawn from sale in 2004.

The average LTV for new business was 65% in the first half of 2009 versus 67% for 2008. The maximum LTV available to new customers remains 90% and there has been strong volumes of low LTV applications in the first half of the year coupled with continued subdued demand for higher LTV business.

The arrears rate (three or more payments missed) on the combined Royal Bank of Scotland and NatWest brands was 1.8% at 30 June 2009, up from 1.5% as at 31 December 2008 and 1.16% as at June 2008. The arrears rate on the buy-to-let portfolio was 1.6% at 30 June 2009 (1.5% at 31 December 2008; 0.9% at 30 June 2008).

The mortgage impairment charge was £65 million in the first half of 2009 versus £33 million for the full year 2008. The increase is mainly attributable to declining house prices driving lower recoveries. Provision cover at 30 June 2009 was 0.20% versus 0.18% at 31 December 2008.

### **Risk and capital management** (continued)

#### **Credit risk** (continued)

The number of repossessions in the first half of 2009 totalled 567, versus 551 in the second half of 2008. Forbearance policies support customers in financial difficulty and include not initiating repossession proceedings for 6 months after a customer falls in to arrears. The Group also participates in the Government's Mortgage Rescue and Homeowner Mortgage Support Schemes.

### **The Republic of Ireland and Northern Ireland residential mortgages**

The residential mortgage portfolio in Ireland across the Ulster Bank and First Active brands totalled £21.8 billion at 30 June 2009; 91.7% is in the Republic of Ireland and 8.3% in Northern Ireland. This represents a decline of 2% in the Republic of Ireland and an increase of 2% in Northern Ireland from balances at 31 December 2008.

During the first half of 2009 loan to value and affordability criteria were further tightened, particularly in higher risk segments, e.g. buy to let. The bank also introduced new products - Momentum and SecureStep - in both Northern Ireland and the Republic of Ireland. These products aim to support market activity while continuing to meet the bank's risk criteria.

The arrears rate (three or more payments missed) increased to 2.7% at 30 June 2009 from 1.5% at 31 December 2008. As a result the loan loss impairment charge for the first half of the year was £42 million versus £23 million for the full year 2008.

Repossessions remained low and totalled 21 for first half of the year, similar to levels experienced in 2008.

### **US residential mortgages**

Citizens Financial Group's (CFG) residential real estate portfolio totalled \$45.9 billion at 30 June 2009 (versus \$50.1 billion at 31 December 2008) comprising \$13.3 billion in first mortgages and \$32.6 billion of home equity loans and lines. Included in this \$4.2 billion decline, is the sale of \$2.4 billion in real estate assets from December through May 2009 to the Federal National Mortgage Association (Fannie Mae) with the remaining fall attributed to pre-payment and declining originations.

CFG has historically adopted conservative risk policies in comparison to the general market. Loan acceptance criteria were tightened further during 2009 to reflect deteriorating economic conditions. Limited exposures to sub-prime underwriting (FICO  $\leq$  620, approximately 0.6%), and Alt-A /other non-conforming balances combined with reduced lending to volatile geographic regions have protected the Bank.

Excluding the Serviced By Others portfolio (SBO) of \$6 billion at 30 June 2009, the portfolio average indexed LTV increased to 68% for June 2009, up from 63% in December 2008. \*

Due to general US economic conditions, delinquencies in the both home equity and mortgage books are steadily rising. At 30 June 2009, 2.7% of home equity loans and 3.7% of mortgages were one payment or more past due (compared to 1.5% and 1.7% respectively at 31 December 2008). Significant investment has been made in problem debt management capability. Loan modification options are being used where appropriate to support troubled customers, including government-sponsored programmes.

Due to its loan to value and geographic profile, the SBO home equity portfolio continues to be particularly affected by the current economic climate, with net credit losses of \$291 million, equivalent to an annualised 9.4% of balances, in the first half of the year (versus 5.3% in 2008). The LTV trend is obscured by the portfolio's contraction with higher LTV a key driver of losses taken to date: average LTV stood at 101% at 30 June 2009 versus 100% at 31 December 2008. Management action to contain losses through optimising problem debt management performance continues to be a specific focus.

*\* Prior period figure has been restated to incorporate updated methodology and additional data.*

### **Risk and capital management (continued)**

#### **Credit risk (continued)**

**Automotive sector**

Exposure to the automotive sector decreased from £13.3 billion at 31 December 2008(1) to £10.8 billion at 30 June 2009.

<b>Credit risk assets by sector</b>	<b>£bn</b>	<b>%</b>
Original equipment manufacturer / Commercial vehicles	<b>1.9</b>	<b>18</b>
Captive finance companies	<b>0.6</b>	<b>5</b>
Component suppliers	<b>1.5</b>	<b>14</b>
Retail / Services	<b>5.0</b>	<b>46</b>
Rental	<b>1.8</b>	<b>17</b>
<b>Total</b>	<b>10.8</b>	<b>100</b>

<b>Credit risk assets by geography</b>	<b>£bn</b>	<b>%</b>
Americas	<b>2.4</b>	<b>22</b>
Central Eastern Europe	<b>0.7</b>	<b>6</b>
UK	<b>4.1</b>	<b>38</b>
Western Europe	<b>2.9</b>	<b>27</b>
Asia	<b>0.7</b>	<b>7</b>
<b>Total</b>	<b>10.8</b>	<b>100</b>

The sector faces numerous challenges: its exposure to discretionary consumer spending; historically high leverage; volatile input prices; and ongoing political and societal pressure to reduce fuel emissions forcing fundamental changes to business and franchise models. The Group therefore maintains a cautious stance against the sector and remains focused on larger, more diversified customers. Notwithstanding this approach, the scale of downturn has impacted the performance of the portfolio with negative rating migration and higher default rates occurring.

Over the past six months, the Group's exposure to the large US automobile manufacturers has been subject to close scrutiny and material reductions in direct lending have been achieved. The resulting size and structure of the facilities were such that minimal provisions were required on exposure to these names.

Note:

(1) Prior period figure has been restated to incorporate updated methodology and additional data.

**Shipping**

The Group's shipping portfolio largely comprises financing exposure, distributed as shown in the table below.

<b>Credit risk assets by sector</b>	<b>£bn</b>	<b>%</b>
-------------------------------------	------------	----------

Dry bulk	2.5	25
Tankers	4.2	41
Container	1.1	11
Gas/offshore	1.8	17
Other	0.6	6
Total	10.2	100

88% of exposure (against delivered tonnage) is secured on vessels built in the last 8 years.

Despite the significant fall in asset values and the challenging outlook across all sectors, all shipping loans are performing. The Group's focus on modern assets, with stronger cash flow and liquidity, is reflected in the fact that only £1.5 billion of the portfolio was subject to enhanced monitoring as at 30 June 2009.

### **Risk and capital management** (continued)

#### **Credit risk** (continued)

#### **Oil and gas**

<b>Credit risk assets by sector</b>	<b>£bn</b>	<b>%</b>
Vertically integrated	5.9	32
Exploration and production	2.7	14
Oilfield services	2.2	12
Midstream	3.2	17
Refining and marketing	3.1	17
Other	1.5	8
Total	18.6	100

RBS and ABN AMRO had a number of exposures that overlapped, primarily in relation to well rated, vertically integrated companies and several of the larger global exploration and production companies. The Group's strategy is to continue to focus primarily on the more stable midstream and integrated oil sectors, together with well secured exposures to larger exploration and production companies based on a conservative outlook for oil prices that is regularly reassessed. Unsecured exposures are primarily to oil majors and state owned entities.

### **Risk and capital management** (continued)

#### **Credit risk** (continued)

#### **Asset quality**

**Loans and advances to customers by geography and industry**

The following table analyses the balance sheet carrying value of loans and advances to customers (excluding reverse repurchase agreements and stock borrowing) by industry and geography.

	30 June 2009			31 December 2008	
	Core £m	Non-core £m	Total £m	2008 £m	2008 £m
<b>UK Domestic</b>					
Central and local government	3,302	138	3,440	3,091	3,381
Finance	17,480	7,462	24,942	28,013	17,940
Individuals - home	85,462	2,048	87,510	80,967	79,114
Individuals - other	23,028	1,096	24,124	26,979	27,264
Other commercial and industrial comprising:					
- Manufacturing	10,762	1,996	12,758	15,067	14,078
- Construction	5,261	3,513	8,774	10,171	10,565
- Service industries and business activities	42,149	12,532	54,681	58,552	58,938
- Agriculture, forestry and fishing	2,839	86	2,925	2,972	2,969
- Property	17,203	33,623	50,826	52,087	50,301
Finance leases and instalment credit	5,026	11,494	16,520	17,363	15,964
Interest accruals	605	188	793	1,687	1,749
	<b>213,117</b>	<b>74,176</b>	<b>287,293</b>	<b>296,949</b>	<b>282,263</b>
<b>UK International</b>					
Central and local government	1,213	61	1,274	3,015	1,255
Finance	19,453	3,810	23,263	35,009	23,541
Individuals - other	375	73	448	490	476
Other commercial and industrial comprising:					
- Manufacturing	7,436	607	8,043	10,932	7,757
- Construction	2,173	820	2,993	3,255	2,645
- Service industries and business activities	23,161	3,137	26,298	29,782	23,562
- Agriculture, forestry and fishing	133	25	158	146	124
- Property	12,670	9,365	22,035	21,923	18,231
Interest accruals	3	445	448	37	31
	<b>66,617</b>	<b>18,343</b>	<b>84,960</b>	<b>104,589</b>	<b>77,622</b>
<b>Overseas</b>					
<b>Europe</b>					
Central and local government	960	534	1,494	1,830	2,709
Finance	2,619	6,134	8,753	9,731	13,501
Individuals - home	14,461	6,582	21,043	23,394	17,893
Individuals - other	2,387	660	3,047	4,641	4,642
Other commercial and industrial comprising:					
- Manufacturing	10,417	6,571	16,988	25,842	15,158
- Construction	2,163	1,670	3,833	5,183	4,674

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- Service industries and business activities	25,341	8,195	33,536	40,444	43,463
- Agriculture, forestry and fishing	1,023	64	1,087	1,327	1,297
- Property	9,846	9,627	19,473	19,769	16,108
Finance leases and instalment credit	322	1,187	1,509	1,815	1,705
Interest accruals	220	234	454	798	799
	<b>69,759</b>	<b>41,458</b>	<b>111,217</b>	134,774	121,949

**Risk and capital management** (continued)

**Credit risk** (continued)

**Asset quality** (continued)

**Loans and advances to customers** (continued)

				31	
				December	30 June
	30 June 2009			2008	2008
	Core	Non-core	Total		
	£m	£m	£m	£m	£m
<b>US</b>					
Central and local government	224	62	286	482	346
Finance	12,924	816	13,740	16,088	12,016
Individuals - home	23,142	4,830	27,972	34,235	26,544
Individuals - other	8,209	3,920	12,129	14,368	10,691
Other commercial and industrial comprising:					
- Manufacturing	6,955	1,997	8,952	13,127	8,529
- Construction	407	282	689	885	673
- Service industries and business activities	17,644	4,620	22,264	27,913	18,973
- Agriculture, forestry and fishing	219	2	221	30	24
- Property	1,944	3,906	5,850	6,579	4,731
Finance leases and instalment credit	2,563	35	2,598	3,066	2,308
Interest accruals	236	119	355	471	383
	<b>74,467</b>	<b>20,589</b>	<b>95,056</b>	117,244	85,218
<b>Rest of World</b>					
Central and local government	375	3	378	7,079	4,942
Finance	8,491	1,378	9,869	11,722	13,968
Individuals - home	397	343	740	795	723
Individuals - other	1,320	560	1,880	4,592	2,853
Other commercial and industrial comprising:					
- Manufacturing	3,558	2,380	5,938	6,196	5,001
- Construction	232	423	655	756	231



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- Service industries and business activities	7,589	2,264	9,853	13,152	10,674
- Agriculture, forestry and fishing	32	187	219	153	104
- Property	693	1,455	2,148	2,918	2,800
Finance leases and instalment credit	34	6	40	111	34
Interest accruals	87	62	149	270	226
	<b>22,808</b>	<b>9,061</b>	<b>31,869</b>	47,744	41,556
<b>Total</b>					
Central and local government	6,074	798	6,872	15,497	12,633
Finance	60,967	19,600	80,567	100,563	80,966
Individuals - home	123,462	13,803	137,265	139,391	124,274
Individuals - other	35,319	6,309	41,628	51,070	45,926
Other commercial and industrial comprising:					
- Manufacturing	39,128	13,551	52,679	71,164	50,523
- Construction	10,236	6,708	16,944	20,250	18,788
- Service industries and business activities	115,884	30,748	146,632	169,843	155,610
- Agriculture, forestry and fishing	4,246	364	4,610	4,628	4,518
- Property	42,356	57,976	100,332	103,276	92,171
Finance leases and instalment credit	7,945	12,722	20,667	22,355	20,011
Interest accruals	1,151	1,048	2,199	3,263	3,188
<b>Loans and advances to customers - gross</b>	<b>446,768</b>	<b>163,627</b>	<b>610,395</b>	701,300	608,608
Loan impairment provisions	(5,449)	(8,198)	(13,647)	(9,324)	(5,031)
<b>Total loans and advances to customers</b>	<b>441,319</b>	<b>155,429</b>	<b>596,748</b>	691,976	603,577

**Risk and capital management** (continued)

**Credit risk** (continued)

**Asset quality** (continued)

**Risk elements in lending**

The following table shows the estimated amount of loans classified as non-accrual, accruing past due and potential problem loans. The figures are stated before deducting the value of security held or related provisions.

	30 June 2009			31 December 2008	30 June 2008
	Core £m	Non-core £m	Total £m	£m	£m
Loans accounted for on a non-accrual basis (2):					
- Domestic	5,295	6,676	11,971	8,579	5,940
- Foreign	3,242	12,016	15,258	8,503	2,148
	<b>8,537</b>	<b>18,692</b>	<b>27,229</b>	17,082	8,088

Accruing loans which are contractually overdue 90 days or more as to principal or interest (3):					
- Domestic	<b>1,460</b>	<b>984</b>	<b>2,444</b>	1,201	642
- Foreign	<b>244</b>	<b>812</b>	<b>1,056</b>	508	102
	<b>1,704</b>	<b>1,796</b>	<b>3,500</b>	1,709	744
Total risk elements in lending	<b>10,241</b>	<b>20,488</b>	<b>30,729</b>	18,791	8,832
Potential problem loans:(4)					
- Domestic	<b>110</b>	<b>163</b>	<b>273</b>	218	139
- Foreign	<b>13</b>	<b>10</b>	<b>23</b>	8	2
	<b>123</b>	<b>173</b>	<b>296</b>	226	141
Closing provisions for impairment as a % of total risk elements in lending and potential problem loans	<b>54%</b>	<b>40%</b>	<b>44%</b>	50%	56%
Risk elements in lending as a % of gross lending to customers excluding reverse repos	<b>2.26%</b>	<b>12.52%</b>	<b>5.04%</b>	2.66%	1.45%
Risk elements in lending and potential problem loans as a % of gross lending to customers excluding reverse repos	<b>2.29%</b>	<b>12.63%</b>	<b>5.08%</b>	2.69%	1.47%

## Notes:

- (1) For the analysis above, 'Domestic' consists of the United Kingdom domestic transactions of the Group. 'Foreign' comprises the Group's transactions conducted through offices outside the UK and through those offices in the UK specifically organised to service international banking transactions.
- (2) All loans against which an impairment provision is held are reported in the non-accrual category.
- (3) Loans where an impairment event has taken place but no impairment recognised. This category is used for fully collateralised non-revolving credit facilities.
- (4) Loans for which an impairment event has occurred but no impairment provision is necessary. This category is used for fully collateralised advances and revolving credit facilities where identification as 90 days overdue is not feasible.

**Risk and capital management** (continued)**Credit risk** (continued)**Impairments**

**Impairment loss provision methodology**

Refer to the Annual Report and Accounts 2008 for information regarding the impairment loss provision methodology.

**Impairment charge**

The following table shows total impairment losses charged to the income statement.

	<b>First half 2009</b>			First half 2008	Full year 2008
	<b>Core £m</b>	<b>Non-core £m</b>	<b>Total £m</b>	£m	£m
New impairment losses	<b>2,257</b>	<b>5,404</b>	<b>7,661</b>	1,617	7,693
Less: recoveries of amounts previously written off	<b>80</b>	<b>60</b>	<b>140</b>	138	261
Charge to income statement	<b>2,177</b>	<b>5,344</b>	<b>7,521</b>	1,479	7,432
Comprising:					
Loan impairment losses	<b>2,170</b>	<b>4,626</b>	<b>6,796</b>	1,406	6,478
Impairment losses on available-for-sale securities	<b>7</b>	<b>718</b>	<b>725</b>	73	954
Charge to income statement	<b>2,177</b>	<b>5,344</b>	<b>7,521</b>	1,479	7,432

	<b>First half 2009</b>	First half 2008	Full year 2008
	<b>£m</b>	£m	£m
Impairment losses by division:			
UK Retail	<b>824</b>	440	1,019
UK Corporate	<b>551</b>	96	321
Wealth	<b>22</b>	5	16
Global Banking & Markets	<b>237</b>	17	541
Global Transaction Services	<b>13</b>	4	48
Ulster Bank	<b>157</b>	18	106
US Retail & Commercial	<b>369</b>	126	437
RBS Insurance	<b>6</b>	-	42
Other	<b>(2)</b>	(36)	(18)
Core	<b>2,177</b>	670	2,512
Non-core	<b>5,344</b>	809	4,920
	<b>7,521</b>	1,479	7,432

**Analysis of loan impairment charge**

	<b>First half 2009</b>		<b>Total £m</b>	First half	Full year
	<b>Core</b>	<b>Non-core</b>		2008	2008
	<b>£m</b>	<b>£m</b>		£m	£m
Latent loss impairment charge	<b>454</b>	<b>270</b>	<b>724</b>	328	769
Collectively assessed impairment charge	<b>1,274</b>	<b>729</b>	<b>2,003</b>	940	2,391
Individually assessed impairment charge (1)	<b>434</b>	<b>3,627</b>	<b>4,061</b>	138	3,200
Charge to income statement	<b>2,162</b>	<b>4,626</b>	<b>6,788</b>	1,406	6,360
Charge as a % of customer loans and advances - gross (2)	<b>0.97%</b>	<b>5.65%</b>	<b>2.22%</b>	0.46%	0.91%

Notes:

(1) Excludes loan impairment charge against loans and advances to banks of £8 million (first half 2008 - nil; full year 2008 - £118 million).

(2) Gross of provisions and excluding reverse repurchase agreements.

**Risk and capital management** (continued)**Credit risk** (continued)**Impairments** (continued)**Loan impairment provisions**

Operating loss is stated after charging loan impairment losses of £6,796 million (first half 2008 - £1,406 million; full year 2008 - £6,478 million). The balance sheet loan impairment provisions increased in the half year ended 30 June 2009 from £9,451 million to £13,773 million, and the movements thereon were:

	<b>First half 2009</b>		<b>Total £m</b>	First half	Full year
	<b>Core</b>	<b>Non-core</b>		2008	2008
	<b>£m</b>	<b>£m</b>		£m	£m
At 1 January	<b>4,905</b>	<b>4,546</b>	<b>9,451</b>	4,956	4,956

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Transfers to disposal groups	-	-	-	(147)	-
Currency translation and other adjustments	(529)	24	(505)	72	1,023
Disposals	-	-	-	(40)	(178)
Amounts written-off	(952)	(980)	(1,932)	(1,261)	(2,897)
Recoveries of amounts previously written-off	80	60	140	138	261
Charge to the income statement	2,170	4,626	6,796	1,406	6,478
Unwind of discount	(99)	(78)	(177)	(90)	(192)
Total	5,575	8,198	13,773	5,034	9,451

Provisions at 30 June 2009 include £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million) in respect of loans and advances to banks.

### Analysis of loan impairment provisions

	30 June 2009			31 December 2008	30 June 2008
	Core	Non-core	Total		
	£m	£m	£m	£m	£m
Latent loss provisions	1,477	822	2,299	1,719	859
Collectively assessed provisions	3,219	1,334	4,553	3,692	3,134
Individually assessed provisions	753	6,042	6,795	3,913	1,038
Total provisions (1)	5,449	8,198	13,647	9,324	5,031
Total provision as a % of customer loans and advances - gross (2)	1.2%	5.0%	2.2%	1.3%	0.8%

Notes:

- (1) Excludes provisions against loans and advances to banks of £126 million (31 December 2008 - £127 million; 30 June 2008 - £3 million).
- (2) Gross of provisions and excluding reverse repurchase agreements.

### Provisions coverage

The Group's provision coverage ratios are shown in the table below.

30 June 2009

30 June

				31	2008
				December	
				2008	
	Core	Non-core	Total		
Total provision expressed as a:					
% of REIL	54%	40%	45%	50%	57%
% of REIL and PPL	54%	40%	44%	50%	56%

## Risk and capital management

### Liquidity risk

The policy of the Group is to ensure that it is able to meet its obligations as they fall due.

The Group has an approved risk appetite supported by explicit targets and metrics to control the size and extent of both short term liquidity and long term funding risk. The Group Asset and Liability Committee (GALCO) chaired by the Group Finance Director has the responsibility to set Group policy and ensure that this is cascaded and communicated to the business divisions.

Group Treasury is the functional area with responsibility for the monitoring and control of the Group's funding and liquidity positions. Group Treasury is supported by a governance process that includes a weekly Liquidity Risk forum comprising functional areas across the organisation responsible for liquidity management, and divisional and regional asset and liability committees.

### Structural balance sheet management

The maturity mismatch between deposits and lending is limited and controlled by policies aimed at ensuring assets can be funded over the term of their economic life. The mismatch analysis takes into account the impact of behaviour under normal and stress conditions to evaluate the appropriate balance of funding resources.

### Stress testing

The Group uses stress tests as a tool to evaluate the impact of both disrupted market conditions and specific events to measure the impact both on, and off, balance sheet. The stress tests show the degree of resilience in times of stress and the ability for contingency actions to mitigate stressed conditions. The assumptions and nature of the risks driving the stress tests are refined and updated in the light of changing conditions.

### Contingency planning

Contingency plans are developed to anticipate the potential for deterioration in market conditions and ensure that the Group has considered how it can respond to adverse developments. The contingency plan considers actions including the use of liquid assets, reduction in lending commitments, increased deposit balances and the use of collateral and management of derivative exposures.

### Global developments in 2009

Liquidity conditions in money and debt markets have improved significantly since the beginning of Q2 2009. Following a difficult first quarter, most indicators of stresses in financial markets are close to or better than before the collapse of Lehman Brothers in September 2008. Contributing to the improvement has been a combination of ongoing central bank and other official liquidity support schemes, guarantee schemes and rate cuts. Signs of improvement in underlying macroeconomic trends also helped to sustain a recovery in markets for risky assets, including in debt markets.

Policy rates have reached low levels for the economic cycle in the major currency areas. Unsecured interbank rates, as benchmarked by Libor/Euribor have fallen to all-time lows - 3 month rates are now well below 1% for prime banks in the G3 currency areas. Trading activity at longer term maturities has also picked up and interbank repo of non-government collateral appears to have recovered strongly following the severe stress experienced in 2008. The US Federal Deposit Insurance Corporation's ('FDIC') Temporary Liquidity Guarantee Program ('TLGP') allowed around \$300 billion of debt to be issued by US financial firms in the first half of the year. A similar amount has been issued by European banks, mostly in EUR and USD, covered by institutions' respective home-country guarantee initiatives. However in recent months unguaranteed financial debt issuance, including bank capital has become possible and guaranteed issuance has slowed markedly since May.

## **Risk and capital management**

### **Liquidity risk** (continued)

Important developments in central bank liquidity programmes since February include:

- In the UK, the Bank of England reduced interest rates to 0.5% in March, and later the same month the Bank of England initiated 'quantitative easing' through its Asset Purchase Facility. Gilt purchases dominate activity to date, while direct purchases of commercial paper and corporate bonds have been relatively small.
- In the US, the Federal Reserve has maintained its target for the funds rate at 0-0.25% while supplementing its credit-easing programmes with a new Term Asset-Backed Securities Loan Facility ('TALF') although initial take up of the TALF has been slow.
- In the Euro Area, the European Central Bank ('ECB') decided in early May to hold three 1-year repo operations against its general collateral list. The first of these was received enthusiastically in June, resulting in significant supply of ECB liquidity to the banking system and bringing downward pressure on short term rates.

### **Liquidity management**

The reduction in the size of the overall funded balance sheet of the Group has reduced reliance on wholesale funding markets. The funding markets have been recovering throughout the course of 2009 and this has eased pressure on the funding position of the Group. The improvements in the markets have enabled the Group to issue £4.9 billion of unguaranteed term debt with maturity beyond 12 months and there has been a reduction of funding in short term debt markets. The structure of the balance sheet has improved and the gap between customer loans and customer deposits (excluding repos) fell by £49,325 million from £240,982 million as at 31 December 2008 to £191,657 million as at 30

June 2009. As a result, the loan to deposit ratio reduced from 152.4% to 144.5%.

The Group continues to develop diversified sources of funding across its retail, corporate and wholesale franchises in line with the strategy to rely more on retail and other customer funds to support its lending business.

The Group will seek to build on this improvement in its funding position in the expectation that trading in term markets improve providing the opportunity to increase the maturity profile of wholesale liabilities.

	First half		Full year	
	2009		2008	
	£m	%	£m	%
Deposits by Banks	<b>135,601</b>	<b>16.3</b>	178,943	18.8
Debt securities in issue:				
Commercial paper	<b>49,270</b>	<b>5.9</b>	69,891	7.3
Certificates of deposits	<b>76,095</b>	<b>9.2</b>	73,925	7.8
MTNs	<b>104,190</b>	<b>12.5</b>	94,298	9.9
Other (bonds)	<b>4,394</b>	<b>0.5</b>	14,231	1.5
Securitisations	<b>14,761</b>	<b>1.8</b>	17,113	1.8
	<b>248,710</b>	<b>29.9</b>	269,458	28.3
Subordinated debt	<b>32,106</b>	<b>3.9</b>	43,678	4.6
Total wholesale funding	<b>416,417</b>	<b>50.1</b>	492,079	51.7
Customer deposits	<b>415,267</b>	<b>49.9</b>	460,318	48.3
Total	<b>831,684</b>	<b>100.0</b>	952,397	100.0

### Customer accounts

Customer accounts are the largest source of funding for the Group and are highly diversified across both retail and corporate franchises, representing a stable source of core funding. The level of customer deposits decreased over the period from £460,318 million at 31 December 2008 to £415,267 million at 30 June 2009.

### Risk and capital management

#### Liquidity risk (continued)

#### Repo agreements

The repo market represents borrowings that are secured against a range of debt assets and other securities. Repo activity represents an ongoing source of financing activity and the market has not stabilised.

#### Debt securities in issue and subordinated liabilities



The proportion of outstanding debt instruments issued, with a remaining maturity of greater than 12 months has increased from 45% in 31 December 2008 to 47% in June 2009 reflecting a lengthening of the maturity profile of debt issuance over the period.

	First half		Full year	
	2009 £m	%	2008 £m	%
Less than one year	<b>149,265</b>	<b>53.2</b>	172,234	55.0
1-5 years	<b>67,390</b>	<b>24.0</b>	61,842	19.8
More than 5 years	<b>64,161</b>	<b>22.8</b>	79,060	25.2
Total	<b>280,816</b>	<b>100.0</b>	313,136	100.0

The reduction in the amount of debt instruments with maturities of less than one year reflects the Group's strategy to reduce its reliance on short-term markets and instruments coupled with favourable exchange rate movements. The net movement in maturities of greater than one year is mainly as a result of the exchange and tender offers completed in April 2009 partially offset by new debt issuance.

#### **Short term debt and bank deposits**

The short term debt markets have improved markedly over the course of 2009 and the Group has been able to readily access this source of funding with increased maturities and reduced costs of spread. This easing of market conditions has enabled the Group to reduce reliance on central bank facilities and move toward its strategic objective of self reliance in the markets.

#### **Undrawn commitments**

The Group has seen a decrease in undrawn commitments from £352 billion at 31 December 2008 to £299 billion at 30 June 2009 both as a result of the strengthening of sterling against the US dollar and the euro as well as decreased volumes. The decrease in volumes is consistent with the strategic objective to reduce liquidity risk in off-balance sheet activity.

#### **Conduits**

The Group has a multi seller conduit business that funds assets through the issuance of short term asset backed commercial paper. The total of assets held in Group sponsored conduits fell from £49.9 billion at December 2008 to £35.0 billion at 30 June 2009 as the Group reduced its exposure to this business in line with strategy.

#### **Risk and capital management**

##### **Market risk**

Market risk arises from changes in interest rates, foreign currency, credit spread, equity prices and risk related factors such as market volatilities. The Group manages market risk centrally within its trading and treasury portfolios through a comprehensive market risk management framework. This framework contains limits based on, but not

limited to: value-at-risk (VaR), scenario analysis, position and sensitivity analyses.

The Group discloses market risk in VaR terms. VaR is a measure that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence levels. The Group uses a historical simulation methodology with a two year time horizon and a 99% confidence level.

At the Group level the risk appetite is expressed in the form of a combination of VaR, sensitivity and scenario limits. The Group recently changed its VaR confidence level from 95% to 99% as it believes this provides greater clarity in respect of potential economic outcomes. The table below sets out VaR for the Group's portfolios with prior periods restated to reflect the 99% confidence level for consistency and comparability.

The Group continued to update and enhance its market risk management framework during the first half of 2009. In addition to the move to VaR based on a 99% confidence level, the Group has improved and strengthened its market risk limit framework, increasing the transparency of market price risk taken across the Group's businesses in both the trading and non-trading portfolios.

The Group's market risk appetite is defined within this limit framework which is cascaded down through legal entity, division, business and ultimately trader level market risk limits.

The VaR disclosure is broken down into trading and non-trading (referred to in previous disclosures as Treasury VaR), where trading VaR relates to the main trading activities of the Group and non-trading reflects the VaR associated with reclassified assets, money market business and the management of internet funds flow within the Group's businesses.

As part of the Strategic Review announced on 26 February 2009, the designation of assets between Core and Non-Core divisions was completed during the period. The period end Core/Non-Core VaR as of 30 June 2009 shown below reflects the conclusion of this process. Average, Maximum and Minimum VaR for Core/Non-Core are measures that require daily data. The Non-Core division was not defined at the start of the period and average, maximum and minimum VaR are measures that require daily data. These three measures have been prepared on a best efforts basis and reflect the process of designating Non-Core assets.

	Average £m	Period end £m	Maximum £m	Minimum £m
<b>Trading VaR (pro forma and statutory basis)</b>				
Interest rate	65.6	81.4	112.8	42.5
Credit spread	125.3	199.6	231.2	66.9
Currency	17.7	15.6	35.8	9.2
Equity	13.0	11.7	21.6	8.3
Commodity	12.7	11.5	21.4	6.5
Diversification effects		(129.2)		
<b>30 June 2009</b>	<b>143.3</b>	<b>190.6</b>	<b>229.0</b>	<b>76.8</b>
Core (30 June 2009)	99.6	94.3	135.6	54.2
Non-Core (30 June 2009)	77.3	130.4	166.5	28.6

**Risk and capital management****Market risk** (continued)

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	38.7	54.4	94.0	18.2
Credit spread	71.5	61.5	130.8	51.7
Currency	7.6	17.0	18.0	3.5
Equity	22.4	18.3	42.6	11.0
Commodity	9.9	10.0	25.8	0.2
Diversification effects		(52.4)		
<b>31 December 2008</b>	<b>82.3</b>	<b>108.8</b>	<b>155.7</b>	<b>49.3</b>
Interest rate	29.1	33.7	56.1	18.2
Credit spread	72.7	75.5	96.3	51.7
Currency	6.0	7.1	8.6	3.5
Equity	23.1	19.9	42.6	11.0
Commodity	9.5	23.0	25.3	0.2
Diversification effects		(67.7)		
<b>30 June 2008</b>	<b>70.4</b>	<b>91.5</b>	<b>106.0</b>	<b>49.3</b>

	Average £m	Period end £m	Maximum £m	Minimum £m
<b>Non-trading VaR (pro forma and statutory basis)</b>				
Interest rate	<b>17.6</b>	<b>16.6</b>	<b>26.1</b>	<b>12.9</b>
Credit spread	<b>198.9</b>	<b>205.4</b>	<b>270.3</b>	<b>65.4</b>
Currency	<b>1.2</b>	<b>1.1</b>	<b>3.8</b>	<b>0.2</b>
Equity	<b>4.0</b>	<b>3.7</b>	<b>7.2</b>	<b>2.2</b>
Diversification effects		(27.0)		
<b>30 June 2009</b>	<b>199.6</b>	<b>199.8</b>	<b>274.9</b>	<b>76.1</b>
Core (30 June 2009)	<b>82.6</b>	<b>81.6</b>	<b>133.5</b>	<b>55.0</b>
Non-Core (30 June 2009)	<b>123.1</b>	<b>132.6</b>	<b>145.3</b>	<b>20.2</b>
Interest rate	10.6	24.4	32.9	5.2
Credit spread	10.5	65.2	65.2	5.5
Currency	0.6	2.2	5.7	0.1
Equity	3.4	7.0	8.0	0.8
Diversification effects		(22.7)		
<b>31 December 2008</b>	<b>14.8</b>	<b>76.1</b>	<b>76.1</b>	<b>7.7</b>

	Average £m	Period end £m	Maximum £m	Minimum £m
Interest rate	7.4	9.1	10.2	5.2
Credit spread	7.7	7.0	10.6	5.6
Currency	0.4	0.3	1.0	0.2
Equity	1.7	1.7	2.6	0.8
Diversification effects		(8.7)		
30 June 2008	10.0	9.4	13.4	7.7

## Risk and capital management

### Market risk (continued)

The data in the tables above exclude exposures to super senior tranches of asset-backed CDOs, as VaR does not provide an appropriate measure of risk for these exposures due to the continued illiquidity and opaqueness of pricing of these instruments. For these exposures, the maximum potential loss is equal to the aggregate net exposure of £548 million at 30 June 2009. For more information, please refer to market turmoil exposure - Super senior CDOs on page 130 and Note 11, Financial instruments - collateralised debt obligations.

The Group uses the most recent two years of market data in its VaR model. Accordingly the VaR at June 2009 incorporates all of the market volatility experienced since the credit crisis began in August 2007. On average this means that a given underlying risk position expressed in VaR terms will be considerably larger than previously reported. If one assumes future volatility declines in comparison to the average over the last two years then the half year may well represent a peak VaR number for a given position. The Group has reduced its underlying trading positions in the first half of 2009, but the increase in market volatility factored into the VaR calculation has more than offset this; consequently the Trading VaR has increased when compared with previous periods.

Non-Core credit spread trading VaR increased materially during the period, not only for the reason described above, but also owing to additional hedges against the risk of counterparty failure. As this counterparty risk is itself not in VaR, these hedges increase reported VaR.

The non-trading VaR increased not only because of more volatile market data in the VaR models, but also as a result of reclassification of certain trading portfolio assets.

The Group's VaR should be interpreted in light of the limitations of the methodologies used, detailed as follows:

- Historical Simulation VaR may not provide the best estimate of future market movements. It can only provide a prediction of the future based on events that occurred in the two year time series. Therefore, events that are more severe than those in the historical data series cannot be predicted.

- VaR that uses a 99% confidence level does not reflect the extent of potential losses beyond that percentile.
- VaR uses a one-day time horizon which will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.
- The Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and intraday profit and losses will be incurred.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

## Risk and capital management

### Market risk (continued)

The following table details the combined other than trading (non-trading businesses and retail and commercial banking activities) VaR at a 99% confidence level, which relates mainly to interest rate risk and credit spreads.

<b>Statutory basis</b>	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	<b>187.2</b>	<b>190.6</b>	<b>203.2</b>	<b>177.3</b>
31 December 2008	133.1	134.9	197.0	86.4

### Structural interest rate and currency VaR (statutory basis)

Structural interest rate risks mainly arise in retail and commercial banking assets and liabilities.

<b>Statutory basis</b>	Average £m	Period end £m	Maximum £m	Minimum £m
30 June 2009	<b>91.3</b>	<b>100.4</b>	<b>112.5</b>	<b>69.3</b>
31 December 2008	128.1	60.1	194.6	60.3

**30 June**

	<b>2009</b>
Statutory basis	<b>£m</b>
EUR	<b>39.3</b>
GBP	<b>25.2</b>
USD	<b>83.8</b>
Other	<b>5.1</b>

## Risk and capital management

### Currency risk (statutory basis)

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding. The Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or the subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. GALCO approves open structural exposures, primarily in USD and EUR and expressed in currency notional amounts, which are sufficient to reduce the sensitivity of regulatory capital ratios to exchange rate movements within defined tolerance limits.

Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity together with the effective portion of foreign exchange differences arising on hedging instruments.

Equity classification of foreign currency denominated preference share issuances requires that these shares be held on the balance sheet at historic cost. Consequently, these share issuances have the effect of increasing the Group's structural foreign currency position.

See the Annual Report and Accounts 2008 for background on the Group's structural currency risk exposures.

The tables below set out the Group's structural foreign currency exposures.

	Net assets of overseas operations £m	Minority Interests £m	Net investments in foreign operations £m	Net investment hedges £m	Structural foreign currency exposures £m
<b>30 June 2009</b>					
US dollar	<b>15,551</b>	<b>(3)</b>	<b>15,554</b>	<b>(3,330)</b>	<b>12,224</b>
Euro	<b>18,282</b>	<b>13,619</b>	<b>4,663</b>	<b>(1,300)</b>	<b>3,363</b>
Other non sterling	<b>5,639</b>	<b>536</b>	<b>5,103</b>	<b>(3,585)</b>	<b>1,518</b>
<b>Total</b>	<b>39,472</b>	<b>14,152</b>	<b>25,320</b>	<b>(8,215)</b>	<b>17,105</b>

31 December 2008

US dollar	17,480	(19)	17,499	(3,659)	13,840
Euro	26,943	15,431	11,512	(7,461)	4,051
Chinese RMB	3,928	1,898	2,030	(1,082)	948
Other non sterling	5,088	621	4,467	(3,096)	1,371
<b>Total</b>	<b>53,439</b>	<b>17,931</b>	<b>35,508</b>	<b>(15,298)</b>	<b>20,210</b>

Retranslation gains and losses on the Group's net investments in operations, together with those on instruments hedging these investments, are recognised directly in equity. Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. A five percent strengthening of foreign currencies would result in a gain of £900 million (31 December 2008 - £1,010 million) recognised in equity. A five percent weakening of foreign currencies would result in a loss of £810 million (31 December 2008 - £960 million) recognised in equity. There are no Chinese RMB exposures at 30 June 2009 following the sale of the Group's interest in Bank of China. These movements in equity would offset retranslation effects on the Group's foreign currency denominated risk weighted assets, reducing the sensitivity of the Group's tier 1 capital ratio to movements in foreign currency exchange rates.

## Risk and capital management

### Market turmoil exposures

#### Explanatory note

These disclosures are focused around certain of the Group's exposures which have been particularly affected by the widespread market disruptions. They reflect the recommendations in the report of the Financial Stability Forum on Enhancing Market and Institutional Resilience and Committee of European Banking Supervisors report on banks' transparency on activities and products affected by the recent market turmoil.

#### Acronyms used in Market turmoil exposures section

The following acronyms are used in this section

ABCP	Asset-backed commercial paper
ABS	Asset-backed security
CDO	Collateralised debt obligation
CDPC	Credit derivative product company
CDS	Credit default swap
CLO	Collateralised loan obligation
CP	Commercial paper
CMBS	Commercial mortgage-backed security
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Corporation
Ginnie Mae	Government National Mortgage Association
GSE	Government Sponsored Entity
IASB	International Accounting Standards Board

RoW	Rest of the world, excluding Europe and US
RMBS	Residential mortgage-backed security
SIV	Structured investment vehicle
SPE	Special purpose entity
US agencies	Ginnie Mae, Fannie Mae, Freddie Mac and similar entities

## Risk and capital management

### Market turmoil exposures (continued)

#### Asset-backed exposures

The carrying value of the Group's debt securities at 30 June 2009 was £229.1 billion compared to £253.2 billion at 31 December 2008 ('2008'). This comprised securities issued by central and local governments of £104.7 billion (2008 - £95.0 billion), asset-backed securities of £90.5 billion (2008 - £111.1 billion), £13.4 billion (2008 - £15.0 billion) of securities issued by banks and building societies and £20.5 billion (2008 - £32.0 billion) issued by corporates, US federal agencies and other entities. This section focuses on asset-backed securities, an area of interest following the market dislocations in 2008.

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

The tables below summarise the net exposures and balance sheet carrying values of these securities by measurement classification, product and geography of underlying assets at 30 June 2009 ('2009') and 31 December 2008.

	Held-for-trading		Available-for-sale		Loans and Designated at				Total	
					receivables		fair value			
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure (1)										
RMBS: G10										
governments (2)	<b>16,228</b>	18,631	<b>29,649</b>	32,926	-	-	-	-	<b>45,877</b>	51,557
RMBS: other	<b>4,003</b>	5,831	<b>7,559</b>	11,524	<b>2,602</b>	2,578	<b>133</b>	182	<b>14,297</b>	20,115
CMBS	<b>1,326</b>	1,178	<b>1,531</b>	918	<b>1,413</b>	1,437	<b>193</b>	13	<b>4,463</b>	3,546
CDOs & CLOs	<b>961</b>	2,463	<b>1,751</b>	2,538	<b>890</b>	1,282	<b>1</b>	-	<b>3,603</b>	6,283
Other ABS	<b>461</b>	195	<b>4,466</b>	6,572	<b>3,841</b>	3,621	<b>16</b>	40	<b>8,784</b>	10,428
Total	<b>22,979</b>	28,298	<b>44,956</b>	54,478	<b>8,746</b>	8,918	<b>343</b>	235	<b>77,024</b>	91,929
Carrying value:										
RMBS: G10										
governments (2)	<b>16,228</b>	18,631	<b>29,649</b>	32,926	-	-	-	-	<b>45,877</b>	51,557
RMBS: other	<b>5,962</b>	9,218	<b>7,839</b>	11,865	<b>2,602</b>	2,618	<b>133</b>	182	<b>16,536</b>	23,883
CMBS	<b>2,241</b>	2,751	<b>1,704</b>	1,126	<b>1,413</b>	1,437	<b>204</b>	13	<b>5,562</b>	5,327



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CDOs & CLOs	<b>6,629</b>	7,774	<b>5,159</b>	9,579	<b>890</b>	1,284	<b>1</b>	-	<b>12,679</b>	18,637
Other ABS	<b>1,479</b>	1,505	<b>4,466</b>	6,572	<b>3,841</b>	3,621	<b>16</b>	41	<b>9,802</b>	11,739
Total	<b>32,539</b>	39,879	<b>48,817</b>	62,068	<b>8,746</b>	8,960	<b>354</b>	236	<b>90,456</b>	111,143

Notes:

- (1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but exclude the effect of counterparty credit valuation adjustments. The hedges provide credit protection of principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.
- (2) RMBS: G10 government securities comprises securities that are:
- (a) guaranteed or effectively guaranteed by the US government, via its support for US federal agencies and GSEs.
  - (b) guaranteed by the Dutch government.
  - (c) covered bonds, referencing primarily Dutch and Spanish government-backed loans.

**Risk and capital management**

**Market turmoil exposures** (continued)

**Asset-backed exposures** (continued)

	US		UK		Europe		RoW		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Net exposure:										
RMBS: G10 governments	<b>30,798</b>	33,508	<b>271</b>	321	<b>14,771</b>	17,682	<b>37</b>	46	<b>45,877</b>	51,557
RMBS: other	<b>4,589</b>	7,012	<b>5,521</b>	6,981	<b>3,728</b>	5,592	<b>459</b>	530	<b>14,297</b>	20,115
CMBS	<b>2,691</b>	1,147	<b>1,115</b>	1,225	<b>618</b>	1,095	<b>39</b>	79	<b>4,463</b>	3,546
CDOs& CLOs	<b>1,886</b>	3,276	<b>124</b>	386	<b>1,578</b>	2,450	<b>15</b>	171	<b>3,603</b>	6,283
Other ABS	<b>2,392</b>	3,508	<b>1,154</b>	1,368	<b>4,644</b>	4,299	<b>594</b>	1,253	<b>8,784</b>	10,428
Total	<b>42,356</b>	48,451	<b>8,185</b>	10,281	<b>25,339</b>	31,118	<b>1,144</b>	2,079	<b>77,024</b>	91,929
Carrying value:										
RMBS: G10 governments	<b>30,798</b>	33,508	<b>271</b>	321	<b>14,771</b>	17,682	<b>37</b>	46	<b>45,877</b>	51,557
RMBS: other	<b>5,067</b>	8,558	<b>6,243</b>	8,105	<b>4,719</b>	6,593	<b>507</b>	627	<b>16,536</b>	23,883
CMBS	<b>3,201</b>	2,144	<b>1,199</b>	1,395	<b>1,017</b>	1,646	<b>145</b>	142	<b>5,562</b>	5,327
CDOs & CLOs	<b>10,094</b>	14,703	<b>224</b>	588	<b>2,185</b>	3,046	<b>176</b>	300	<b>12,679</b>	18,637
Other ABS	<b>2,966</b>	3,582	<b>1,252</b>	1,622	<b>4,694</b>	5,098	<b>890</b>	1,437	<b>9,802</b>	11,739
Total	<b>52,126</b>	62,495	<b>9,189</b>	12,031	<b>27,386</b>	34,065	<b>1,755</b>	2,552	<b>90,456</b>	111,143

**Risk and capital management****Market turmoil exposures** (continued)**Asset-backed exposures** (continued)

Asset backed securities ('ABS') are securities with an interest in an underlying pool of referenced assets. The risks and rewards of the referenced pool are passed on to investors by the issue by a special purpose entity of securities with varying seniority. The tables below analyse carrying values of the Group's ABS by rating, measurement classification and fair value hierarchy level.

	RMBS				CDOs				Total £m
	G10 government-ments £m	Prime £m	Non conforming £m	Sub-prime £m	CMBS £m	& CLOs £m	Other ABS £m		
<b>30 June 2009</b>									
AAA rated:(1)									
Held-for-trading	16,228	4,317	194	306	1,789	3,816	486	27,136	
Available-for-sale	29,261	4,786	706	401	1,311	4,014	3,341	43,820	
Loans and receivables	-	582	1,327	194	229	320	939	3,591	
Designated at fair value	-	120	-	13	199	-	-	332	
	45,489	9,805	2,227	914	3,528	8,150	4,766	74,879	
BBB- and above rated:(1)									
Held-for-trading	-	640	67	230	416	771	634	2,758	
Available-for-sale	388	867	245	200	271	461	988	3,420	
Loans and receivables	-	163	156	159	1,169	549	1,972	4,168	
Designated at fair value	-	-	-	-	5	-	16	21	
	388	1,670	468	589	1,861	1,781	3,610	10,367	
Non-investment grade:(1)									
Held-for-trading	-	24	91	92	36	1,439	70	1,752	
Available-for-sale	-	257	265	111	3	411	17	1,064	
Loans and receivables	-	6	5	10	7	-	285	313	
	-	-	-	-	-	-	-	-	

Designated at fair value

-	287	361	213	46	1,850	372	3,129
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Not publicly rated:

Held-for-trading	-	1	-	-	603	289	893
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Available-for-sale	-	-	1	-	119	273	513
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Loans and receivables	-	-	-	-	8	21	645	674
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Designated at fair value	-	-	-	-	-	1	-	1
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-	1	1	-	127	898	1,054	2,081
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Total:

Held-for-trading	16,228	4,982	352	628	2,241	6,629	1,479	32,539
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Available-for-sale	29,649	5,910	1,217	712	1,704	5,159	4,466	48,817
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Loans and receivables	-	751	1,488	363	1,413	890	3,841	8,746
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Designated at fair value	-	120	-	13	204	1	16	354
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Total	45,877	11,763	3,057	1,716	5,562	12,679	9,802	90,456
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Of which carried at fair value:

Level 2(2)	45,877	10,562	1,559	1,342	3,794	9,611	5,301	78,046
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Level 3(3)	-	448	11	11	355	2,180	658	3,663
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45,877	11,010	1,570	1,353	4,149	11,791	5,959	81,709
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**Risk and capital management**

Market turmoil exposures (continued)

Asset-backed exposures (continued)

**RMBS****CDOs**

	<b>G10 governments</b>	<b>Prime</b>	<b>Non conforming</b>	<b>Sub-prime</b>	<b>CMBS</b>	<b>&amp; CLOs</b>	<b>Other ABS</b>	<b>Total</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>31 December 2008</b>								

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AAA rated:(1)								
Held-for-trading	18,622	6,226	203	393	2,306	4,698	380	32,828
Available-for-sale	2,926	8,384	1,914	522	982	6,459	4,826	56,013
Loans and receivables	-	476	1,415	431	405	652	1,443	4,822
Designated at fair value	-	166	-	16	9	-	-	191
	51,548	15,252	3,532	1,362	3,702	11,809	6,649	93,854

BBB- and above rated:(1)								
Held-for-trading	-	985	79	564	407	1,439	890	4,364
Available-for-sale	-	338	194	267	144	1,642	1,292	3,877
Loans and receivables	-	94	64	105	1,031	561	1,296	3,151
Designated at fair value	-	-	-	-	4	-	41	45
	-	1,417	337	936	1,586	3,642	3,519	11,437

Non-investment grade:(1)								
Held-for-trading	-	59	69	636	38	1,299	120	2,221
Available-for-sale	-	47	74	124	-	1,057	50	1,352
Loans and receivables	-	-	3	30	-	-	72	105
Designated at fair value	-	-	-	-	-	-	-	-
	-	106	146	790	38	2,356	242	3,678

Not publicly rated:								
Held-for-trading	9	2	1	1	-	338	115	466
Available-for-sale	-	-	1	-	-	421	404	826
Loans and receivables	-	-	-	-	1	71	810	882
Designated at fair	-	-	-	-	-	-	-	-

value

	9	2	2	1	1	830	1,329	2,174
Total:								
Held-for-trading	18,631	7,272	352	1,594	2,751	7,774	1,505	39,879
Available-for-sale	2,926	8,769	2,183	913	1,126	9,579	6,572	62,068
Loans and receivables	-	570	1,482	566	1,437	1,284	3,621	8,960
Designated at fair value	-	166	-	16	13	-	41	236
Total	51,557	16,777	4,017	3,089	5,327	18,637	11,739	111,143
Of which carried at fair value:								
Level 2(2)	51,322	16,062	2,485	2,459	3,316	14,643	6,677	96,964
Level 3(3)	235	145	50	64	574	2,710	1,441	5,219
	51,557	16,207	2,535	2,523	3,890	17,353	8,118	102,183

Notes:

- (1) Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto the S&P scale.
- (2) Valuation is based significantly on observable market data. Instruments in this category are valued using:
  - (a) quoted prices for identical instruments in markets which are not considered to be active; or quoted prices for similar instruments trading in active or not so active markets; or
  - (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.
- (3) Instruments in this category have been valued using a valuation technique where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

## Risk and capital management

### Market turmoil exposures (continued)

#### Residential mortgage-backed securities

Residential mortgage backed securities ('RMBS') are securities that represent an interest in a portfolio of residential mortgages. Repayments made on the underlying mortgages are used to make payments to holders of the RMBS. The

risk of the RMBS will vary primarily depending on the quality of the underlying mortgages and the credit enhancement in the securitisation structure.

Several tranches of notes are issued, each secured against the same portfolio of mortgages, but providing differing levels of seniority to match the risk appetite of investors. The most junior (or equity) notes will suffer early capital and interest losses experienced by the referenced mortgage collateral, with each more senior note benefiting from the protection provided by the subordinated notes below. Additional credit enhancements may be provided to the holder of senior RMBS notes, including guarantees over the value of the exposures, often provided by monoline insurers.

The Group's ABS are analysed below by geographic region and nature of collateral. The US market has more established definitions for the quality of the underlying mortgage collateral and these are used as the basis for the Group's RMBS categorisation:

**G10 governments** - collateral comprises guaranteed mortgages and covered mortgage bonds. Guaranteed mortgages are mortgages that form part of a mortgage backed security issuance by a government agency, or in the US, an entity that benefits from a guarantee (direct or indirect) provided by the US government. For US RMBS, this category includes, amongst others, RMBS issued by US agencies such as Ginnie Mae, Freddie Mac and Fannie Mae. For European RMBS this includes mortgages guaranteed by the Dutch government. Covered mortgage bonds, primarily referencing Dutch and Spanish government-backed loans, are debt instruments that have recourse to a pool of mortgage assets, where investors have a preferred claim if a default occurs. These underlying assets are segregated from the other assets held by the issuing entity.

**Prime** - the underlying mortgages are of a higher credit quality than non-conforming and sub-prime mortgages (see below), but exclude G10 government mortgages.

**Non-conforming (or 'Alt-A' used for US exposures)** - the underlying mortgages have a higher credit quality than sub-prime mortgages, but lower than those for prime borrowers. Within the US mortgage industry, non-conforming mortgages are those that do not meet the lending criteria for US agency mortgages (described above). For non-US mortgages, judgement is applied in identifying loans with similar characteristics to US non-conforming loans, and also includes self-certified loans. Alt-A describes a category of mortgages in which lenders consider the risk to be greater than prime mortgages though less than sub-prime. The offered interest rate is usually representative of the associated risk level.

**Sub-prime** - the underlying mortgages are loans to sub-prime borrowers typically having weakened credit histories that include payment delinquencies, and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.

## Risk and capital management

### Market turmoil exposures (continued)

### Residential mortgage-backed securities (continued)

The tables below shows the Group's RMBS net exposures and carrying values by underlying asset type, measurement classification, the geographical location of the property securing the mortgage and the year in which the underlying securitisation was originated.

30 June 2009				31 December 2008				
G10	Non			G10	Non			
govern-ments	Prime	conforming	Sub-prime	Total	govern-ments	Prime	conforming	Sub-prime

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	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Total</b>									
Net exposure:(1)									
Held-for-trading	16,228	3,218	346	439	20,231	18,631	5,140	346	34,356
Available-for-sale	29,649	5,910	1,217	432	37,208	32,926	8,768	2,184	57,935
Loans and receivables	-	751	1,488	363	2,602	-	569	1,482	52,837
Designated at fair value	-	120	-	13	133	-	166	-	10,185
	45,877	9,999	3,051	1,247	60,174	51,557	14,643	4,012	1,460,000
Carrying values:(2)									
Held-for-trading	16,228	4,982	352	628	22,190	18,631	7,272	352	1,594,000
Available-for-sale	29,649	5,910	1,217	712	37,488	32,926	8,769	2,183	913,000
Loans and receivables	-	751	1,488	363	2,602	-	570	1,482	560,000
Designated at fair value	-	120	-	13	133	-	166	-	10,000
	45,877	11,763	3,057	1,716	62,413	51,557	16,777	4,017	3,083,000

Notes:

- (1) Net exposures represent the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment. Carrying value is the amount recorded on the balance sheet.
- (2) Carrying value is the amount recorded on the balance sheet.
- (3) G10 government RMBS net exposures and carrying values include:
  - (a) £6.7 billion (2008 - £7.6 billion) available-for-sale exposures guaranteed by the Dutch government.
  - (b) £6.9 billion (2008 - £5.7 billion) guaranteed by the US government via Ginnie Mae of which £1.1 billion (2008 - £0.5 billion) are held-for-trading.
  - (c) £23.8 billion (2008 - £ 27.8 million) effectively guaranteed by the US government by way of its support for Freddie Mac and Fannie Mae of which £15.1 billion (2008 - £18.1 billion) are held-for-trading.
  - (d) £8.0 billion (2008 - £10.0 billion) all classified as available-for-sale, covered bonds.

**Risk and capital management**

**Market turmoil exposures** (continued)

**Residential mortgage-backed securities** (continued)

30 June 2009					31 December 2008			
US agency	Prime	Alt-A	Sub-prime	Total	Prime	Alt-A	Sub-prime	Total

## US agency

	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>United States</b>										
Net exposure:										
Held-for-trading	16,191	433	346	439	17,409	18,577	968	346	302	20,193
Available-for-sale	14,607	2,667	566	51	17,891	14,932	4,364	760	53	20,109
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,184	912	493	35,387	33,509	5,547	1,106	358	40,520
Carrying values:										
Held-for-trading	16,191	490	353	575	17,609	18,577	1,043	352	1,427	21,399
Available-for-sale	14,607	2,668	566	328	18,169	14,932	4,364	760	394	20,450
Loans and receivables	-	84	-	3	87	-	215	-	3	218
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067
Of which originated in:										
2004 and earlier	8,260	701	95	308	9,364	5,534	709	122	474	6,839
2005	3,131	801	501	164	4,597	6,014	2,675	718	259	9,666
2006	1,039	925	105	187	2,256	1,690	614	115	718	3,136
2007 and later	18,368	815	218	247	19,648	20,271	1,624	157	373	22,425
	30,798	3,242	919	906	35,865	33,509	5,622	1,112	1,824	42,067

	30 June 2009					31 December 2008				
	Guaranteed	Prime	Non conforming	Sub-prime	Total	Guaranteed	Prime	Non conforming	Sub-prime	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>United Kingdom</b>										
Net exposure:										
Held-for-trading	-	239	-	-	239	9	249	-	-	33
Available-for-sale	271	2,493	651	79	3,494	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
Designated at fair value	-	120	-	13	133	-	166	-	-	16
	271	3,166	2,015	340	5,792	322	3,666	2,905	408	7,301
Carrying values:										
Held-for-trading	-	954	-	5	959	9	1,336	-	-	70
Available-for-sale	271	2,493	651	81	3,496	313	3,133	1,423	154	5,023
Loans and receivables	-	314	1,364	248	1,926	-	118	1,482	205	1,805
	-	120	-	13	133	-	166	-	-	16



Designated at fair value

<b>271</b>	<b>3,881</b>	<b>2,015</b>	<b>347</b>	<b>6,514</b>	322	4,753	2,905	445	8,425
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Of which

originated in:

2004 and earlier	<b>7</b>	<b>273</b>	-	<b>32</b>	<b>312</b>	9	806	-	72	887
2005	-	<b>776</b>	-	<b>24</b>	<b>800</b>	-	1,000	652	42	1,694
2006	<b>8</b>	<b>1,957</b>	<b>464</b>	<b>127</b>	<b>2,556</b>	13	2,295	756	209	3,273
2007 and later	<b>256</b>	<b>875</b>	<b>1,551</b>	<b>164</b>	<b>2,846</b>	300	652	1,497	122	2,571
	<b>271</b>	<b>3,881</b>	<b>2,015</b>	<b>347</b>	<b>6,514</b>	322	4,753	2,905	445	8,425

**Risk and capital management****Market turmoil exposures** (continued)**Residential mortgage-backed securities** (continued)

	30 June 2009					31 December 2008				
	Guaranteed	Covered	Prime and non-conforming	Sub-prime	Total	Guaranteed	Covered	Prime	Sub-prime	
<b>Europe</b>	(1)	(2)	(3)			(1)	(2)			
	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Net exposure										
Held-for-trading	-	-	2,542	-	2,542	-	-	3,898	10	
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,106	57	
Loans and receivables	-	-	450	103	553	-	-	208	313	
	6,722	8,049	3,584	144	18,499	7,642	10,040	5,212	380	
Carrying values										
Held-for-trading	-	-	3,525	8	3,533	-	-	4,839	30	
Available-for-sale	6,722	8,049	592	41	15,404	7,642	10,040	1,107	57	
Loans and receivables	-	-	451	102	553	-	-	208	352	
	6,722	8,049	4,568	151	19,490	7,642	10,040	6,154	439	
Of which originated in:										
2004 and earlier	377	632	684	25	1,718	418	702	954	48	
2005	1,033	2,364	754	27	4,178	1,165	2,993	1,090	17	
2006	1,758	3,822	1,585	84	7,249	2,059	4,466	2,466	148	
2007 and later	3,554	1,231	1,545	15	6,345	4,000	1,879	1,644	226	

6,722      8,049                      4,568                      151 19,490                      7,642 10,040 6,154                      439

## Notes:

- (1) Guaranteed by the Dutch government
- (2) Covered bonds referencing primarily Dutch and Spanish mortgages
- (3) Non-conforming net exposures and carrying values: £123 million at 30 June 2009 (2008 - nil)

**Risk and capital management****Market turmoil exposures** (continued)**Residential mortgage-backed securities** (continued)

	30 June 2009				31 December 2008			
	Guaranteed £m	Prime £m	Sub-prime £m	Total £m	Guaranteed £m	Prime £m	Sub-prime £m	Total £m
<b>Rest of the World</b>								
Net exposure								
Held-for-trading	37	4	-	41	46	24	-	70
Available-for-sale	-	156	263	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	188	271	496	46	216	314	576
Carrying values								
Held-for-trading	37	11	41	89	46	54	67	167
Available-for-sale	-	157	262	419	-	164	308	472
Loans and receivables	-	28	8	36	-	28	6	34
	37	196	311	544	46	246	381	673
Of which originated in:								
2004 and earlier	-	25	58	83	-	37	65	102
2005	-	1	33	34	-	30	34	64
2006	37	3	175	215	46	2	187	235
2007 and later	-	167	45	212		177	95	272
	37	196	311	544	46	246	381	673

## **Risk and capital management**

### **Market turmoil exposures** (continued)

#### **Residential mortgage-backed securities** (continued)

**US** - the Group's largest concentration of RMBS assets is the portfolio of US agency asset-backed securities comprising mainly current year vintage positions amounting to £30.8 billion at 30 June 2009 (2008: £33.5 billion). Due to the US government backing, explicit or implicit, in these securities, the counterparty credit risk exposure is low. £16.2 billion (2008: £18.6 billion) is held in actively traded portfolios, actively transacted, and possesses a high degree of liquidity. Trading in this portfolio has driven a shift to more recent vintages. However, the majority of the decrease in exposure during the period has been due to the strengthening of sterling against the US dollar. Available-for-sale exposures of £14.6 billion (£14.9 billion) relate to liquidity portfolios held by US Retail & Commercial.

**Europe** - these are liquidity portfolios comprising £6.7 billion (2008 - £7.6 billion) available-for-sale portfolio of European RMBS, referencing primarily Dutch and Spanish government-backed loans and £8.0 billion (2008 - £10.0 billion) of European RMBS comprised covered mortgage bonds. The decrease in both of these portfolios primarily reflects exchange rate movements. These exposures are part of the liquidity portfolios held by Group Treasury.

**UK and the rest of the world** - the Group has other portfolios of RMBS from secondary trading activities, warehoused positions previously acquired with the intention of further securitisation and a portfolio of assets from the unwinding of a securities arbitrage conduit. This conduit was established to benefit from the margin between the assets purchased and the notes issued.

Material disposals of prime RMBS occurred in the period, in particular £1.5 billion of 2005 vintage US securities, £0.5 billion of Spanish and Portuguese mortgages and £0.6 billion of positions which have synthetic hedges against them. Other declines were due to redemptions and foreign exchange movements. Sub-prime balances reduced across ratings, geographies and vintages, due to pay downs, maturities and sales during the period, while non-conforming exposures fell mainly due to UK available-for-sale redemptions.

## **Risk and capital management**

### **Market turmoil exposures** (continued)

#### **Commercial mortgage-backed securities**

Commercial mortgage-backed securities ('CMBS') are securities that are secured by loans mortgaged on commercial land and buildings. The securities are structured in the same way as an RMBS but typically the underlying assets referenced will be of greater individual value. The performance of the securities is dependent on the sector of the occupier of the commercial property and the geographical region.

The Group accumulated CMBS for the purpose of re-securitisation and secondary trading. The largest holding of CMBS arose as a result of the Group's purchase of senior tranches in mezzanine and high grade CMBS structures from third parties. These securities are predominantly hedged with monoline insurers. As a result, the Group's risk is limited to the counterparty credit risk exposure on the hedge provider.

The following table shows the composition of the Group's holdings of CMBS portfolios.

**30 June 2009**

**31 December 2008**

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	US £m	UK £m	Europe £m	RoW £m	Total £m	US £m	UK £m	Europe £m	RoW £m	Total £m
US federal agency	1,418	n/a	n/a	n/a	1,418	649	n/a	n/a	n/a	649
Office	641	770	242	-	1,653	428	915	402	-	1,745
Retail	460	45	66	39	610	295	43	2	49	389
Mixed use	62	27	473	3	565	20	99	975	45	1,139
Multi-family	279	131	3	-	413	159	143	-	-	302
Hotel	119	26	-	-	145	40	35	-	-	75
Healthcare	1	30	75	-	106	24	13	81	-	118
Leisure	-	77	-	-	77	-	76	-	-	76
Industry	63	-	8	-	71	40	-	49	-	89
Other	159	92	150	103	504	490	71	137	47	745
	<b>3,202</b>	<b>1,198</b>	<b>1,017</b>	<b>145</b>	<b>5,562</b>	<b>2,145</b>	<b>1,395</b>	<b>1,646</b>	<b>141</b>	<b>5,327</b>

Underlying CMBS carrying values declined due to foreign exchange movements driven by the strengthening of sterling against the US dollar and the euro, as well as modest pay downs, sales and write-downs. This was partially offset by revised asset classifications, including US federal agency issued securities.

There have been no material acquisitions of CMBS by the Group in the period. Where exposures within CMBS types have increased, this is due to a change of sector exposure from permitted substitutions, particularly within US structures, and revised sector classifications.

#### Asset-backed collateralised debt and loan obligations

Collateralised debt obligations ('CDOs') are securities whose performance is dependant on a portfolio of underlying cash and synthetic exposures to referenced assets generally ABS, but may also include other classes of assets. The collateralised loan obligations ('CLOs') have referenced portfolios which primarily consist of leveraged loans.

The Group's ABS CDO and CLO net exposures comprised:

	<b>30 June 2009 £m</b>	31 December 2008 £m
Super senior CDOs	<b>548</b>	1,182
Other CDOs	<b>909</b>	1,658
CLOs	<b>2,146</b>	3,443
	<b>3,603</b>	6,283

#### Risk and capital management

**Market turmoil exposures** (continued)

The Group's CDO exposures comprise:

- Super senior CDO risk structured by the Group from 2003 to 2007 that the Group was unable to sell to third parties due to prevailing illiquid markets, with net exposures of £0.5 billion (2008: £1.2 billion).
- Other CDO net exposures of £0.9 billion (2008:£1.7 billion) purchased from third parties, some of which are fully hedged through CDS with other banks or monoline insurers.

Given the significance of net losses incurred on super senior CDOs in recent years, additional disclosures on these exposures are discussed below.

**Super senior CDOs**

Super senior CDOs represent the most senior positions in a CDO. Instruments subordinate to the super senior CDO (usually a combination of equity, mezzanine and senior notes) absorb losses before the super senior note is affected. Losses will only be suffered by the super senior note holders once defaults on the underlying reference assets exceed a specified threshold. This threshold is usually referred to in terms of a percentage of defaults in the asset pool; known as the 'attachment point'. These super senior instruments carry an AAA rating at origination or are senior to other AAA rated notes in the same structure. The level of defaults occurring on recent vintage sub-prime mortgages and other asset classes has been higher than originally expected. As a result the protection afforded by the subordinate securities has been significantly eroded and consequently the super senior notes have a higher probability of suffering losses than at origination. The majority of the underlying collateral is now rated below investment grade.

Depending on the quality of the underlying reference assets on issue, the super senior tranches will be either classified as high grade or mezzanine. The majority of the Group's exposure relates to high grade super senior tranches of ABS CDOs. The table below summarises the carrying amounts and net exposures after hedge protection of the Group's super senior CDOs as at 30 June 2009. The collateral rating is determined with reference to S&P ratings where available. Where S&P ratings are not available the lower of Moody's and Fitch ratings have been used.

	30 June 2009(1)			31 December 2008(2)		
	High grade £m	Mezzanine £m	Total £m	High grade £m	Mezzanine £m	Total £m
Gross exposure	<b>6,314</b>	<b>2,586</b>	<b>8,900</b>	7,104	2,884	9,988
Hedges and protection	<b>(3,040)</b>	<b>(614)</b>	<b>(3,654)</b>	(3,423)	(691)	(4,114)
	<b>3,274</b>	<b>1,972</b>	<b>5,246</b>	3,681	2,193	5,874
Write-downs on net open positions and amortisations	<b>(2,756)</b>	<b>(1,942)</b>	<b>(4,698)</b>	(2,592)	(2,100)	(4,692)

Net exposure after hedges and						
write-downs	<b>518</b>	<b>30</b>	<b>548</b>	1,089	93	1,182
Average price	<b>17%</b>	<b>3%</b>	<b>16%</b>	29%	6%	23%

## Notes:

- (1) Net exposure represents the carrying value after taking account of hedge protection purchased from monolines and other counterparties but excludes the effect of counterparty credit valuation adjustment; includes portfolios carried at fair value only.
- (2) Exposures at 31 December 2008 have been restated to reflect transactions that have been liquidated and now represent long positions in asset-backed securities.

**Risk and capital management****Market turmoil exposures** (continued)

The change in net exposure during the year is analysed in the table below.

	<b>High grade £m</b>	<b>Mezzanine £m</b>	<b>Total £m</b>
Net exposure at 1 January 2009	<b>1,089</b>	<b>93</b>	<b>1,182</b>
Write downs	<b>(417)</b>	<b>(50)</b>	<b>(467)</b>
Foreign exchange and other movements	<b>(154)</b>	<b>(13)</b>	<b>(167)</b>
Net exposure at 30 June 2009	<b>518</b>	<b>30</b>	<b>548</b>

During 2009 the super senior exposures, which are predominantly US positions, have fallen by approximately 50%. This reflects the further price declines in the underlying collateral as well as the foreign exchange effect as sterling has strengthened against the US dollar in the first half of 2009.

**Other CDOs**

The net exposure of the Group's other senior CDO exposures was £0.9 billion after hedge protection with financial institutions (more than 80%) or monolines. The unhedged exposures comprise smaller positions with various types of underlying collateral, rating and vintage characteristics. The positions hedged with derivative protection from financial institutions include a number of positions referencing early vintages of RMBS and other ABS assets. The Group therefore has no net exposure to these CDOs before credit valuation adjustment. Due to the early vintage,

the assets underlying these structures have not deteriorated to the same degree as the more recently issued securities. During 2009 the other CDO exposures, which are predominantly US positions, have fallen significantly. This reflects further price declines in the underlying collateral as well as the strengthening of sterling against the US dollar in the first half of 2009. The price declines relate to exposures with more recent vintages.

## CLOs

The Group's CLO exposures arise from its trading activities and consist of retained interests and from notes purchased from third-party structures. The Group holds super senior securities in two CLO structures which were originated by the Group in 2005 and 2007. The underlying collateral of these structures predominantly references leveraged loans.

In the first half of 2009, there were further write downs in line with the decline in the market, some deal amortisations and disposal of positions where market opportunities occurred.

## Risk and capital management

### Market turmoil exposures (continued)

#### Other asset backed securities

Other asset backed securities are securities issued by securitisation vehicles, similar to those in RMBS and CMBS structures, which reference cash flow generating assets other than mortgages. The wide variety of referenced underlying assets results in diverse asset performance levels.

The Group has accumulated these assets from a range of trading and funding activities. The carrying value of the Group's other asset-backed securities by underlying asset type and geographical region are shown below.

	30 June 2009					31 December 2008				
	US £m	UK £m	Europe £m	RoW £m	Total £m	US £m	UK £m	Europe £m	RoW £m	Total £m
Covered bonds	-	-	2,190	-	2,190	-	-	3,301	-	3,301
Consumer	245	182	1,071	499	1,997	956	408	118	729	2,211
Aircraft leases	380	13	8	65	466	459	23	-	273	755
Other leases	16	611	286	-	913	1	492	455	-	948
Student loans	694	-	-	-	694	953	-	-	-	953
Trade receivables	623	7	-	-	630	15	9	-	-	24
Utilities and energy	241	2	283	177	703	47	19	48	143	257
Auto and equipment	90	8	337	3	438	160	30	466	29	685
Film/entertainment	-	-	-	-	-	86	-	-	-	86
Other	677	429	519	146	1,771	904	641	710	263	2,518
	<b>2,966</b>	<b>1,252</b>	<b>4,694</b>	<b>890</b>	<b>9,802</b>	<b>3,581</b>	<b>1,622</b>	<b>5,098</b>	<b>1,437</b>	<b>11,738</b>

The covered bonds comprise asset-backed securities issued by Spanish financial institutions. These securities benefit from credit enhancement provided by the issuing institutions. The reduction in carrying value of the Group's Other

ABS exposures reflects asset disposals, and the strengthening of sterling against the US dollar and the euro. There have been no material acquisitions of other ABS by the Group in the period. Where exposures within specific asset types have increased, this is due to a combination of permitted substitutions within structures and revised sector classifications, particularly in relation to other consumer and trade receivable positions.

## Risk and capital management

### Market turmoil exposures (continued)

### Counterparty valuation adjustments

### Credit valuation adjustments

Counterparty valuation adjustments ('CVAs') represent an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures. During 2009, as credit spreads of monoline insurers have generally widened, there has been an increase in the total CVA as set out in the table below.

	<b>30 June</b>	31 December
	<b>2009</b>	2008
	<b>£m</b>	£m
Monoline insurers	<b>6,845</b>	5,988
CDPCs	<b>821</b>	1,311
Other counterparties	<b>1,821</b>	1,738
Total CVA adjustments	<b>9,487</b>	9,037

The Group has purchased protection from monoline insurers ("monolines") mainly against specific ABS, CDOs and CLOs. Monolines are entities which specialise in providing credit protection against the notional and interest cash flows due to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps ('CDS') referencing the underlying exposures held by the Group.

The Group has also purchased credit protection, both tranching and single name credit derivatives, from credit derivative product companies ('CDPC'). CDPCs are similar to monolines however they are not regulated as insurers. The Group's exposure to CDPCs is predominantly due to tranching credit derivatives ("tranches"). A tranche references a portfolio of assets and provides protection against total portfolio default losses exceeding a certain percentage of the portfolio notional (the attachment point) up to another percentage (the detachment point). The Group has predominantly traded senior tranches with CDPCs, the average attachment and detachment points are 15% and 50% respectively, and the majority of the loans and bonds in the reference portfolios are investment grade.

The CVA for monolines is calculated on a trade-by-trade basis, and is derived using market observable monoline credit spreads. The majority of the monoline CVA relates to credit derivatives hedging exposures to ABS. The CDPC CVA is calculated using a similar approach. However, in the absence of market observable credit spreads, the cost of hedging the counterparty risk is estimated by analysing the underlying trades and the cost of hedging expected default losses in excess of the capital available in each vehicle.



The CVA for all other counterparties is calculated with reference to observable credit spreads. The calculation is performed on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the risk.

The widening of monoline credit spreads during the year contributed to a significant increase in the total size of CVA adjustments recorded.

## Risk and capital management

### Market turmoil exposures (continued)

#### Monoline insurers

The Group's monoline exposures are predominantly denominated in US dollars and the weakening of the US dollar against sterling has significantly reduced the gross exposure to these counterparties. This has been partially offset by an increase in the fair value of the CDS protection from monolines as the market price of the securities protected continued to decline.

The perceived credit quality of the monolines has also continued to deteriorate as reflected by ratings downgrades, wider credit spreads and lower recovery rate assumptions seen in the market. This has resulted in increased levels of CVA being recorded against the Group's monoline exposure.

Summary of the Group's exposure to monoline counterparties:

	<b>30 June</b>	31 December
	<b>2009</b>	2008
	<b>£m</b>	£m
Gross exposure to monolines	<b>10,950</b>	11,581
Hedges with financial institutions	<b>(524)</b>	(789)
Credit valuation adjustment	<b>(6,845)</b>	(5,988)
Net exposure to monolines	<b>3,581</b>	4,804

The net income statement effect arising from the change in level of monoline CVA and related trades is shown below. The US dollar weakening against sterling is the primary cause of the loss arising on foreign exchange, hedges and other movements.

	<b>£m</b>
Credit valuation adjustment at 1 January 2009	<b>(5,988)</b>
Credit valuation adjustment at 30 June 2009	<b>(6,845)</b>
Increase in credit valuation adjustment	<b>(857)</b>
Foreign exchange and other movements	<b>(937)</b>
Net effect relating to reclassified debt securities	<b>(27)</b>

**(1,821)****Risk and capital management****Market turmoil exposures** (continued)**Monoline insurers** (continued)

The asset categories protected by CDSs written by monolines and the related CVA by monoline credit rating at the balance sheet date are analysed in the table below.

	30 June 2009				31 December 2008			
	Fair value:		Gross exposure	Credit valuation adjustment	Notional amount: protected assets	Fair value: protected assets	Gross exposure	Credit valuation adjustment
Notional amount: protected assets	Protected assets	£m						
AAA/AA rated:								
CDO of								
RMBS	-	-	-	-	-	-	-	-
RMBS	3	2	1	-	3	2	1	-
CMBS	503	357	146	61	613	496	117	51
CLOs	5,610	4,219	1,391	599	6,506	4,882	1,624	718
Other ABS	1,308	849	459	206	1,548	990	558	251
Other	265	174	91	44	267	167	100	47
	<b>7,689</b>	<b>5,601</b>	<b>2,088</b>	<b>910</b>	<b>8,937</b>	<b>6,537</b>	<b>2,400</b>	<b>1,067</b>
A/BBB rated:								
CDO of								
RMBS	-	-	-	-	5,385	1,363	4,022	1,938
RMBS	-	-	-	-	90	63	27	10
CMBS	-	-	-	-	4,236	1,892	2,344	1,378
CLOs	-	-	-	-	6,009	4,523	1,486	778
Other ABS	-	-	-	-	910	433	477	243
Other	-	-	-	-	265	122	143	79
	-	-	-	-	<b>16,895</b>	<b>8,396</b>	<b>8,499</b>	<b>4,426</b>
Sub-investment grade:								
CDO of								
RMBS	4,972	687	4,285	2,745	394	32	362	263
RMBS	76	64	12	2	-	-	-	-

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CMBS	3,757	1,212	2,545	1,886	-	-	-	-
CLOs	4,953	3,795	1,158	797	350	268	82	60
Other ABS	1,747	1,129	618	353	1,208	1,037	171	123
Other	488	244	244	152	237	169	68	49
	<b>15,993</b>	<b>7,131</b>	<b>8,862</b>	<b>5,935</b>	2,189	1,506	683	495
Total:								
CDO of								
RMBS	4,972	687	4,285	2,745	5,779	1,395	4,384	2,201
RMBS	79	66	13	2	93	65	28	10
CMBS	4,260	1,569	2,691	1,947	4,849	2,388	2,461	1,429
CLOs	10,563	8,014	2,549	1,396	12,865	9,673	3,192	1,557
Other ABS	3,055	1,978	1,077	559	3,666	2,460	1,206	616
Other	753	418	335	196	769	458	311	176
	<b>23,682</b>	<b>12,732</b>	<b>10,950</b>	<b>6,845</b>	28,020	16,439	11,581	5,988

The Group also has indirect exposure to monolines through wrapped securities and other assets with credit enhancement monolines. These securities are traded with the benefit of this credit enhancement. Any deterioration in the credit rating of the monoline is reflected in the fair value of these assets.

## Risk and capital management

### Market turmoil exposures (continued)

#### Credit derivative product companies

The Group's exposure to CDPCs has reduced considerably due to a combination of tighter credit spreads and a decrease in the relative value of senior tranches compared to the underlying reference portfolios. The trades with CDPCs are predominantly denominated in US and Canadian dollars and therefore the strengthening of sterling against these currencies has further reduced the exposure.

The overall level of CVA has decreased in line with the reduction in the exposure, however, on a relative basis the CVA has increased. This reflects the perceived deterioration of the credit quality of the CDPCs as reflected by ratings downgrades.

Summary of the Group's exposure to CDPC:

	<b>30 June</b>	31 December
	<b>2009</b>	2008
	<b>£m</b>	£m
Gross exposure to CDPCs	<b>2,303</b>	4,776
Credit valuation adjustment	<b>(821)</b>	(1,311)
Net exposure to CDPCs	<b>1,482</b>	3,465

The net income statement effect arising from the change in level of CVA and related trades is shown in the table below. The Group has additional market risk hedges in place which effectively cap the exposure to CDPCs where the Group has significant risk. As the exposure to these CDPCs has reduced, losses have been incurred on the additional hedges. These losses, together with losses arising on trades hedging CVA, are the primary cause of the loss arising on hedges, foreign exchange and other movements.

	<b>£m</b>
Credit valuation adjustment at 1 January 2009	<b>(1,311)</b>
Credit valuation adjustment at 30 June 2009	<b>(821)</b>
Decrease in credit valuation adjustment	<b>490</b>
Hedges, foreign exchange and other movements	<b>(1,059)</b>
	<b>(569)</b>

## Risk and capital management

### Market turmoil exposures (continued)

#### Credit derivative product companies (continued)

Further analysis of the Group's exposure to CDPCs by CDPC credit rating is shown below. Some of the CDPCs with the AAA/AA and A/BBB rating at 31 December 2008 were subsequently downgraded or had ratings withdrawn.

	30 June 2009				31 December 2008			
	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m	Notional amount: protected assets £m	Fair value: protected reference assets £m	Gross exposure £m	Credit valuation adjustment £m
AAA/AA rated	1,636	1,580	56	18	19,092	15,466	3,626	908
A/BBB rated	15,965	14,484	1,481	470	6,147	4,997	1,150	403
Sub-investment grade	1,399	1,097	302	151	-	-	-	-
Rating withdrawn	3,914	3,450	464	182	-	-	-	-
	<b>22,914</b>	<b>20,611</b>	<b>2,303</b>	<b>821</b>	<b>25,239</b>	<b>20,463</b>	<b>4,776</b>	<b>1,311</b>

**Risk and capital management****Market turmoil exposures** (continued)**Leveraged finance**

Leveraged finance is employed to facilitate corporate finance transactions, such as acquisitions or buy-outs. A bank acting as a lead manager will typically underwrite a loan, alone or with others, and then syndicate the loan to other participants ('syndicate portfolio'). The Group has typically also held a portion of these loans as part of its long term portfolio once primary syndication is completed ('hold portfolio').

Since the beginning of the credit market dislocation in the second half of 2007, investor appetite for leveraged loans and similar risky assets has fallen dramatically, with secondary prices falling due to selling pressure and margins increasing, and reduced activity in the primary market. There were a small number of modest deals with reduced leverage executed in the first half of 2008 priced at less than mid-2007 levels. Concerted efforts to sell positions during the first half of 2008 were only partially successful due to the rapid deterioration in market conditions since origination of the loans. Most of the leveraged finance loans held as part of syndicated lending activity were reclassified from the held-for-trading to loans and receivables in the second half of 2008.

During the first half of 2009, there have been a small number of sales and further impairments have been recorded. The strengthening of sterling against other major currencies also had a substantial impact on this book, which has significant US dollar and euro positions.

The table below shows the Group's leveraged finance exposures by industry and geography.

	30 June 2009					31 December 2008				
	Americas £m	UK £m	Europe £m	RoW £m	Total £m	Americas £m	UK £m	Europe £m	RoW £m	Total £m
Gross exposure:										
TMT (1)	1,625	1,652	1,477	506	5,260	2,507	1,484	2,001	535	6,527
Industrial	1,616	1,553	1,641	175	4,985	1,686	1,612	1,924	188	5,410
Retail	69	1,134	1,327	79	2,609	268	1,285	1,440	89	3,082
Other	350	1,566	1,228	131	3,275	487	1,391	1,282	126	3,286
	<b>3,660</b>	<b>5,905</b>	<b>5,673</b>	<b>891</b>	<b>16,129</b>	<b>4,948</b>	<b>5,772</b>	<b>6,647</b>	<b>938</b>	<b>18,305</b>
Net exposure:										
TMT (1)	1,283	1,517	1,367	506	4,673	2,247	1,385	1,982	534	6,148
Industrial	578	1,126	1,416	172	3,292	607	1,157	1,758	186	3,708
Retail	69	537	1,257	79	1,942	223	978	1,424	89	2,714
Other	350	1,383	1,204	131	3,068	484	1,307	1,281	127	3,199
	<b>2,280</b>	<b>4,563</b>	<b>5,244</b>	<b>888</b>	<b>12,975</b>	<b>3,561</b>	<b>4,827</b>	<b>6,445</b>	<b>936</b>	<b>15,769</b>
Of which:										
Drawn	1,825	3,859	4,193	813	10,690	2,511	4,125	5,159	824	12,619
Undrawn	455	704	1,051	75	2,285	1,050	702	1,286	112	3,150
	<b>2,280</b>	<b>4,563</b>	<b>5,244</b>	<b>888</b>	<b>12,975</b>	<b>3,561</b>	<b>4,827</b>	<b>6,445</b>	<b>936</b>	<b>15,769</b>

Of which:

Syndicate

portfolio

(2)	<b>1,428</b>	<b>1,398</b>	<b>1,125</b>	<b>88</b>	<b>4,039</b>	2,138	2,121	1,663	101	6,023
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Hold

portfolio	<b>852</b>	<b>3,165</b>	<b>4,119</b>	<b>800</b>	<b>8,936</b>	1,423	2,707	4,783	835	9,746
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	<b>2,280</b>	<b>4,563</b>	<b>5,244</b>	<b>888</b>	<b>12,975</b>	3,561	4,827	6,445	936	15,769
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Notes:

(1) Telecommunications, media and technology

(2) includes held-for-trading exposures of £38 million (2008 - £102 million)

**Risk and capital management****Market turmoil exposures** (continued)**Leveraged finance** (continued)

The table below analyses the movement in the amounts reported above.

	Drawn £m	Undrawn £m	Total £m
Balance at 1 January 2009	<b>12,619</b>	<b>3,150</b>	<b>15,769</b>
Transfers in (from credit trading business)	<b>506</b>	<b>41</b>	<b>547</b>
Sales	<b>(327)</b>	<b>(147)</b>	<b>(474)</b>
Repayments and facility reductions	<b>(549)</b>	<b>(314)</b>	<b>(863)</b>
Funded deals	<b>97</b>	<b>(97)</b>	<b>-</b>
Lapsed/collapsed deals	<b>(28)</b>	<b>(19)</b>	<b>(47)</b>
Changes in fair value	<b>(34)</b>	<b>(6)</b>	<b>(40)</b>
Accretion of interest	<b>71</b>	<b>n/a</b>	<b>71</b>
Impairment provisions	<b>(679)</b>	<b>n/a</b>	<b>(679)</b>
Exchange and other movements	<b>(986)</b>	<b>(323)</b>	<b>(1,309)</b>
Balance at 30 June 2009	<b>10,690</b>	<b>2,285</b>	<b>12,975</b>

**Risk and capital management****Market turmoil exposures** (continued)**SPEs and conduits**

**SPEs**

For background on the Group's involvement with securitisations and special purpose entities ('SPEs'), refer to Business Review - SPEs and conduits in the Annual Report and Accounts 2008.

The table below sets out the asset categories together with the carrying amount of the assets and associated liabilities for those securitisations and other asset transfers, other than conduits (discussed below), where the assets continue to be recorded on the Group's balance sheet.

	<b>30 June 2009</b>		31 December 2008	
	<b>Assets</b>	<b>Liabilities</b>	Assets	Liabilities
	<b>£m</b>	<b>£m</b>	£m	£m
Residential mortgages	<b>62,799</b>	<b>17,812</b>	49,184	20,075
Credit card receivables	<b>2,975</b>	<b>1,567</b>	3,004	3,197
Other loans	<b>10,472</b>	<b>1,031</b>	1,679	1,071
Finance lease receivables	<b>950</b>	<b>750</b>	1,077	857

The increase in residential mortgage and other loan assets above primarily relate to balances that have been securitised to facilitate access to central bank special liquidity schemes. As all the notes issued by the SPEs are purchased by Group companies, securitised assets are significantly greater than secured liabilities.

**Conduits**

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

The Group's conduits can be divided into multi-seller conduits and own-asset conduits. The Group consolidates both types of conduit where the substance of the relationship between the Group and the conduit vehicle is such that the vehicle is controlled by the Group. The Group also extends liquidity commitments to multi-seller conduits sponsored by other banks, but typically does not consolidate these entities.

**Funding and liquidity**

The Group's multi-seller conduits have continued to fund the vast majority of their assets solely through ABCP issuance. There have been no significant systemic failures within the financial markets similar to that experienced in the second half of 2008 following Lehman Brothers bankruptcy filing in September 2008. The improvement in market conditions has allowed these conduits to move towards more normal ABCP funding and reduced the need for backstop funding from the Group.

The Group's own-asset conduit programmes have been established to diversify the Group's funding. The conduits allow the Group to access central government funding schemes and the external ABCP market.

The average maturity of ABCP issued by the Group's conduits as at 30 June 2009 was 55.2 days compared with 72.1 days at 31 December 2008 due to a combination of restructured deals having shorter terms than normal rolling periods and effect of issuers seeking longer terms at end of any year due to general illiquidity at the end of the year/early

January.

## **Risk and capital management**

### **Market turmoil exposures** (continued) .

The total assets held by the Group's sponsored conduits are £35.0 billion (31 December 2008 - £49.9 billion). Since the related backstop liquidity facilities are sanctioned on the basis of total conduit purchase commitments, the liquidity facility commitments exceed the level of assets held, with the difference representing undrawn commitments.

### **Multi-seller conduits**

The Group sponsors six multi-seller conduits which finance assets from Europe, North America and Asia-Pacific. Assets purchased or financed by the multi-seller conduits include auto loans, residential mortgages, credit card receivables, consumer loans and trade receivables. These conduits were established to provide customers of the Group access to diversified and flexible funding sources.

The third-party assets financed by the conduits receive credit enhancement from the originators of the assets. This credit enhancement, which is specific to each transaction, can take the form of over-collateralisation, excess spread or subordinated loan, and typically ensures the asset acquired by the conduit has a rating equivalent to at least a single-A credit. In addition, in line with general market practice, the Group provides a small second-loss layer of programme-wide protection to the multi-seller conduits. Given the nature and investment grade equivalent quality of the first loss enhancement provided by the originators of the assets, the Group has only a minimal risk of loss on its programme wide exposure. The issued ABCP is rated A-1 / P-1 by Moody's and Standard & Poor's.

The Group provides liquidity back-up facilities to the conduits it sponsors. The conduits are able to draw funding under these facilities in the event of a disruption in the ABCP market, or when certain trigger events prevent the issue of ABCP. The maturity of commercial paper issued by the Group's conduits is managed to mitigate the short-term contingent liquidity risk of providing back-up facilities. Group limits sanctioned for such liquidity facilities as at 30 June 2009 totalled approximately £28.2 billion (31 December 2008 - £42.9 billion). For a very small number of transactions within one multi-seller conduit the liquidity facilities have been provided by third-party banks, this typically occurs on transactions where the third-party bank does not use, or have, its own conduit vehicles.

The multi-seller conduits form the majority of the Group's conduit business (64.2% (31 December 2008 - 69.4%).

The Group's maximum exposure to loss on its multi-seller conduits is £28.3 billion (31 December 2008 - £43.2 billion), being the total amount of the Group's liquidity commitments plus the extent of programme-wide credit enhancements of conduit assets for which liquidity facilities were provided by third parties.

### **Own-asset conduits**

The Group also holds three own-asset conduits which have assets that have previously been funded by the Group. These vehicles represent 28% (31 December 2008 - 25%) of the Group's conduit business (as a percentage of the total liquidity and credit enhancements committed by the Group), with £11.8 billion of ABCP outstanding at 30 June 2009 (31 December 2008 - £14.8 billion). The Group's maximum exposure to loss on its own-asset conduits is £12.9 billion (31 December 2008 - £15.9 billion), being the total drawn and undrawn amount of the Group's liquidity commitments to these conduits.

### **Securitisation arbitrage conduits**



The Group no longer sponsors any securitisation arbitrage conduits.

## Risk and capital management

### Market turmoil exposures (continued) .

#### Conduits (continued)

The Group's exposure from conduits which are consolidated by the Group including those to which the Group is economically exposed on a shared basis with other consortium members and its involvement with third-party conduits, are set out below.

	30 June 2009			31 December 2008		
	Sponsored conduits £m	Third party £m	Total £m	Sponsored conduits £m	Third party £m	Total £m
Total assets held by the conduits	<b>35,007</b>			49,857		
Commercial paper issued	<b>33,452</b>			48,684		
Liquidity and credit enhancements:						
Deal specific liquidity:						
- drawn	<b>1,440</b>	<b>2,361</b>	<b>3,801</b>	1,172	3,078	4,250
- undrawn	<b>39,744</b>	<b>1,161</b>	<b>40,905</b>	57,929	198	58,127
Programme-wide liquidity:						
- drawn	-	<b>99</b>	<b>99</b>	-	102	102
- undrawn	-	-	-	-	504	504
PWCE (1)	<b>1,663</b>	-	<b>1,663</b>	2,391	-	2,391
	<b>42,847</b>	<b>3,621</b>	<b>46,468</b>	61,492	3,882	65,374
Maximum exposure to loss (2)	<b>41,184</b>	<b>3,621</b>	<b>44,805</b>	59,101	3,882	62,983

Notes:

(1) Programme-wide credit enhancement

(2) Maximum exposure to loss is determined as the Group's total liquidity commitments to the conduits and additionally programme-wide credit support which would absorb first loss on transactions where liquidity support is provided by a third party.

The Group's exposures from the conduit shared with the other consortium members is set out below:

	<b>30 June</b>	31
		December
	<b>2009</b>	2008
	<b>£m</b>	£m
Total assets held by the conduits	<b>11,189</b>	13,286
Commercial paper issued	<b>11,189</b>	13,028
Liquidity and credit enhancements:		
Deal specific liquidity:		
- drawn	-	258
- undrawn	<b>11,311</b>	13,566
	<b>11,311</b>	13,824
Maximum exposure to loss	<b>11,311</b>	13,824

During the period both multi-seller and own asset conduit assets have been reduced in line with the wider Group balance sheet management.

## Risk and capital management

### Market turmoil exposures (continued)

#### Conduits (continued)

Collateral analysis, geographic, profile, credit ratings and weighted average lives of the assets in the assets relating to the Group's consolidated conduits and related undrawn commitments are set out in the tables below.

	Funded assets			Undrawn £m	Liquidity for third parties	Total exposure
	Loans £m	Securities £m	Total £m		£m	£m
<b>30 June 2009</b>						
Auto loans	5,785	280	6,065	1,838	-	7,903
Corporate loans	213	9,193	9,406	186	-	9,592
Credit card receivables	3,375	-	3,375	1,601	-	4,976
Trade receivables	1,437	-	1,437	790	-	2,227
Student loans	1,260	-	1,260	265	(132)	1,393
Consumer loans	1,742	-	1,742	520	-	2,262
Mortgages:						
- Prime	3,971	1,900	5,871	230	-	6,101
- Non-conforming	1,821	-	1,821	468	-	2,289
- Sub-prime	-	-	-	-	-	-

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- Commercial	656	499	1,155	87	(22)	1,220
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,349	1,526	2,875	292	-	3,167
	21,609	13,398	35,007	6,277	(154)	41,130

**31 December 2008**

Auto loans	9,924	383	10,307	1,871	-	12,178
Corporate loans	430	11,042	11,472	534	-	12,006
Credit card receivables	5,844	-	5,844	922	-	6,766
Trade receivables	2,745	-	2,745	1,432	(71)	4,106
Student loans	2,555	-	2,555	478	(132)	2,901
Consumer loans	2,371	-	2,371	409	-	2,780
Mortgages						
- Prime	4,416	2,250	6,666	1,188	-	7,854
- Non-conforming	2,181	-	2,181	727	-	2,908
- Sub-prime	-	-	-	-	-	-
- Commercial	1,228	507	1,735	66	(23)	1,778
- Buy-to-let	-	-	-	-	-	-
CDOs	-	-	-	-	-	-
Other	1,851	2,130	3,981	1,615	-	5,596
	33,545	16,312	49,857	9,242	(226)	58,873

**Risk and capital management**

**Market turmoil exposures** (continued)

**Conduits** (continued)

	Geographic distribution					CP funded assets					
	UK	Europe	US	RoW	Total	Years	Weighted Credit ratings (S&P equivalent) average life				
	£m	£m	£m	£m	£m		AAA	AA	A	BBB	Below
							£m	£m	£m	£m	£m
<b>30 June 2009</b>											
Auto loans	595	1,075	3,846	549	6,065	1.9	3,085	2,274	706	-	-
Corporate loans	1,266	3,640	2,738	1,762	9,406	1.7	9,078	223	105	-	-
Credit card receivables	390	-	2,796	189	3,375	1.0	2,794	212	369	-	-
Trade receivables	-	465	637	335	1,437	1.1	349	561	496	31	-
Student loans	116	-	1,144	-	1,260	1.2	1,144	116	-	-	-

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Consumer loans	657	999	86	-	1,742	2.4	71	132	1,539	-	-
Mortgages											
Prime	-	1,896	-	3,975	5,871	2.8	2,364	3,448	20	-	39
Non-conforming	808	1,013	-	-	1,821	4.5	316	460	1,045	-	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	685	373	57	40	1,155	15.1	-	31	745	373	6
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	243	900	383	1,349	2,875	2.4	90	432	2,210	143	-
	4,760	10,361	11,687	8,199	35,007	2.4	19,291	7,889	7,235	547	45

**31 December  
2008**

Auto loans	801	1,706	7,402	398	10,307	1.7	6,075	883	3,349	-	-
Corporate Loans	1,714	4,347	3,289	2,122	11,472	4.9	10,767	132	573	-	-
Credit card receivables	633	-	4,999	212	5,844	0.7	3,465	62	2,171	146	-
Trade receivables	68	922	1,371	384	2,745	0.7	120	1,025	1,600	-	-
Student loans	144	-	2,411	-	2,555	2.6	2,296	144	115	-	-
Consumer loans	708	1,195	468	-	2,371	1.7	387	993	923	68	-
Mortgages											
Prime	-	2,244	-	4,422	6,666	2.8	2,675	3,876	115	-	-
Non-conforming	960	1,221	-	-	2,181	4.6	351	368	475	987	-
Sub-prime	-	-	-	-	-	-	-	-	-	-	-
Commercial	713	453	74	495	1,735	11.0	274	518	474	469	-
Buy-to-let	-	-	-	-	-	-	-	-	-	-	-
CDOs	-	-	-	-	-	-	-	-	-	-	-
Other	166	1,198	684	1,933	3,981	1.2	3	958	2,786	234	-
	5,907	13,286	20,698	9,966	49,857	3.0	26,413	8,959	12,581	1,904	-

**Risk and capital management**

**Market turmoil exposures** (continued)

**Structured investment vehicles**

The Group does not sponsor any structured investment vehicles.

**Investment funds set up and managed by the Group**

The Group has established and manages a number of money market funds for its customers. When a new money market fund is launched, the Group typically provides a limited amount of seed capital to the funds. The Group has investments in these funds of £723.2 million at 30 June 2009 (31 December 2008: £107.0 million). These funds are not consolidated by the Group.

### Money market funds

The Group's money market funds held assets of £13.2 billion at 30 June 2009 (31 December 2008 - £13.9 billion). The sub-categories of money market funds are:

- £9.1 billion (31 December 2008 - £8.3 billion) in money market funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in short-dated, highly rated money market securities with the objective of ensuring stability of capital and net asset value per share, appropriate levels of liquid assets, together with an income which is comparable to the short dated money market interest rate in the relevant currency.
- £0.7 billion (31 December 2008 - £0.8 billion) in money market 'Plus' funds managed by the Group denominated in sterling, US dollars and euro. The funds invest in longer-dated, highly rated securities with the objective of providing enhanced returns over the average return on comparable cash deposits.
- £3.4 billion (31 December 2008 - £4.8 billion) in third party multi-manager money market funds denominated in sterling, US dollars and euro. The funds invest in short dated, highly rated securities with the objective of maximising current income consistent with the preservation of capital and liquidity.

### Non-money market funds

The Group has also established a number of non-money market funds to enable investors to invest in a range of assets including bonds, equities, hedge funds, private equity and real estate. As the Group does not have significant holdings in these funds, they are not consolidated by the Group.

The Group non-money market funds had total assets of £14.2 billion at 30 June 2009 (31 December 2008 - £17.7 billion). The sub-categories of non-money market funds are:

- £1.1 billion (31 December 2008 - £1.1 billion) in committed capital to generate returns from equity and equity-like investments in private companies.
- £12.8 billion (31 December 2008 - £16.5 billion) in third party, multi-manager funds. These funds offer multi-manager and fund of funds' products across bond, equity, hedge fund, private equity and real estate asset classes.
- £0.3 billion (31 December 2008 - £0.1 billion) in various derivative instruments with the objective of providing returns linked to the performance of underlying equity indices.

The investors in both money market and non money market funds have recourse to the assets of the funds only. At 30 June 2009 the Group had exposure to one fund amounting to £145 million (31 December 2008 - £144 million).

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### Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: 07 August, 2009

THE ROYAL BANK OF SCOTLAND  
GROUP plc (Registrant)

By: /s/ A N Taylor

Name: A N Taylor

Title: Head of Group Secretariat