RBS Holdings N.V.
Form 20-F
March 28, 2013

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

FORM 20-F

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

OR

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

For the fiscal year ended December 31, 2012

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

OR

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

Commission file number: 1-14624

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

The Netherlands
(Jurisdiction of incorporation)

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

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

Title of each class	Name of each exchange on which registered
Guarantee of 5.90% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust V	New York Stock Exchange*
Guarantee of 6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VI	New York Stock Exchange**
Guarantee of 6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VII	New York Stock Exchange***
5.90% Non-cumulative Guaranteed Trust Preferred	New York Stock Exchange

Securities of RBS Capital Funding Trust V	
6.25% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VI	New York Stock Exchange
6.08% Non-cumulative Guaranteed Trust Preferred Securities of RBS Capital Funding Trust VII	New York Stock Exchange

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

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

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

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

(Title of each class)	(Number of outstanding shares)
Ordinary shares, par value €0.56 per share	89,287

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

o Yes x No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

o Yes x No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

o Yes o No

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

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

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

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

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

o Item 17 o Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

Annual report and accounts

SEC form 20-F cross reference

SEC form 20-F cross reference continued

Chairman's Statement

In January 2012, the Royal Bank of Scotland Group plc (RBSG) announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes resulted in the reorganisation of RBSG's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities. The changes ensure the wholesale businesses continue to deliver against RBSG Group's strategy.

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

An inevitable consequence of these changes is the need for a smaller workforce. To return to sustainable profitability, the businesses within the bank need to be improved against a backdrop of challenging market conditions and a tougher regulatory environment. In parallel with the reshaping of its wholesale banking business, RBS Holdings N.V. has been looking at its support infrastructure in order to achieve an optimal operating set-up and cost base. This review has led to a decision to reduce the number of roles in the Netherlands by approximately 500 FTEs. RBS Holdings N.V. will, of course, do everything it can to support redundant employees find new jobs, either within or outside RBSG and its consolidated subsidiaries and associated companies (RBSG Group). The implementation of these reductions will take place by the end of 2013.

The restructure has no impact on RBS Holdings N.V.'s clients as it remains committed to the reshaped wholesale banking proposition, delivering market-leading debt financing, risk management, foreign exchange, rates and transaction services, supported by RBS Holdings N.V.'s extensive international network.

On 19 April 2011 it was announced that the Boards of RBSG Group, The Royal Bank of Scotland plc (RBS plc), RBS Holdings N.V. and The Royal Bank of Scotland N.V. (RBS N.V.) had approved the proposed transfers of a substantial part of the business activities of RBS N.V. to RBS plc (the Transfers). This is subject to, amongst other matters, regulatory and other approvals, further tax and other analysis in respect of the assets and liabilities to be transferred and employee consultation procedures. The Transfers streamline the manner in which RBSG Group interacts with its clients, providing simplified access to the RBSG Group's Markets and International Banking products.

The first phase of the Transfers took place during the last quarter of 2011 with the successful transferring of certain businesses of RBS N.V. carried on in the United Kingdom to RBS plc. Further more, substantial progress was made in transferring businesses to RBS plc during 2012. In the first half of 2012, assets and liabilities largely relating to businesses in Singapore, Hong Kong and Kazakhstan were transferred to RBS plc.

On 8 August 2012 the Court of Session in Scotland approved the planned transfer of eligible RBS N.V. businesses, including the transfers of certain securities issued by RBS N.V., in the Netherlands and certain EMEA countries to RBS plc on 10 September 2012. The transfer was executed by way of a Dutch statutory demerger, then onto RBS plc by way of a cross-border merger.

Also in the latter half of 2012, other eligible businesses in the Netherlands and certain EMEA countries, and businesses in Malaysia, Turkey and the United Arab Emirates were transferred to RBS plc.

Employees working for RBS Holdings N.V. transferred with the businesses transferring to RBS plc, with no change in their terms and conditions of employment as a result of the transfer. Of the remaining employees in RBS N.V., 79 are employed in the Netherlands and 11,230 in locations outside of the Netherlands.

The remainder of the Transfers are expected to take place during 2013, subject to, amongst other matters, regulatory and other approvals, further tax and other analysis in respect of the assets and liabilities to be transferred and employee consultation procedures. RBS Holdings N.V. has concluded that it will no longer be possible to transfer its businesses in China before conclusion of the Transfers programme at the end of 2013. Consideration is being given to the options for the transfer of businesses in China at a later date. As announced on 19 April 2011, RBSG is committed to providing the necessary support to ensure that RBS N.V. continues to meet its commitments during and after the Transfers.

Results of operations in 2012

Operating loss before tax was €887 million compared with a loss of €186 million in 2011. This was largely due to a decrease in other operating income as a result of a €2,155 million lower own credit adjustment attributable to the tightening of credit spreads in 2012. In addition, net interest income and fee and commission income decreased following the transfer of businesses to RBS plc. This was partially offset by lower impairment losses. The large impairment losses in 2011 related to Greek sovereign available-for-sale bonds and related interest rate hedge adjustments. In the first half of 2012, as part of Private Sector Involvement in the Greek government bail-out, the vast majority of this portfolio was exchanged for Greek sovereign debt and European Financial Stability Facility notes; the Greek sovereign debt received in the exchange was sold.

Outlook

Economic and regulatory challenges present in 2011 and 2012 are expected to continue into 2013. Growth prospects remain subdued, while a degree of macro-economic risk persists in the eurozone and more generally within the global economy. Against this backdrop, commercial performance is expected to remain broadly stable benefiting modestly from improvement in impairments. In Markets, revenue performance will remain market-dependent. The continuing run-off of Non-Core is expected to crystallise further disposal losses, though overall Non-Core losses are expected to fall. RBS Holdings N.V. expects to continue the further removal of risk through the Transfers, while maintaining adequate capital ratios.

On behalf of the Managing Board, I would like to thank all our employees and clients for their continued commitment during 2012.

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

Amsterdam, 27 March 2013

Presentation of information

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

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

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

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

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

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

Glossary
A glossary of terms is detailed on pages 253 to 258.

Forward-looking statements

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

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

Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements contained in this document include, but are not limited to: the financial condition of RBSG Group; global economic and financial market conditions and the continuing economic crisis in Europe; their impact on the financial industry in general and on RBSH Group in particular; competition and consolidation in the banking sector; other geopolitical risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; pension fund shortfalls; the ability to access sufficient sources of liquidity and funding; ineffective management of capital or changes to capital adequacy or liquidity requirements; changes in the credit ratings of RBSH Group; changes to regulatory requirements relating to capital and liquidity; ongoing organisational restructuring; the ability to implement strategic plans on a timely basis, or at all, including the disposal of certain Non-Core assets and assets and businesses; regulatory or legal changes (including those requiring any restructuring of RBSH Group's operations) in the Netherlands, the United States, the United Kingdom, the rest of Europe and other countries in which RBSH Group operates or a change in policy of the government of the Netherlands; legal and regulatory actions and investigations; changes to the valuation of financial instruments recorded at fair value; changes in Dutch and foreign laws, regulations, accounting standards and taxes; general operational risks; information technology systems failure, loss of service availability or breach of data security; employee misconduct, negligence or fraud; reputational risk; the ability of RBSH Group to attract or retain senior management or other key employees; the cross liability resulting from the legal demerger of ABN AMRO Banks N.V. and the Dutch Scheme; and the success of RBSH Group in managing the risks involved in the foregoing. The forward-looking statements contained in this document speak only as of the date of this announcement, and RBSH Group does not undertake to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

For a further discussion of certain risks faced by RBSH Group, see Risk factors on pages 243 to 251.

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

Business review

Description of business

Introduction

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

In 2007, RFS Holdings, which was jointly owned by RBSG, Fortis (succeeded by the Dutch State in 2008) and Santander (together, the 'Consortium Members') completed the acquisition of RBS Holdings.

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

As at 31 December 2010, RBSG's shareholding in RFS Holdings was increased to 97.72%. RFS Holdings is controlled by RBSG, which is incorporated in the UK and registered at 36 St. Andrew Square, Edinburgh, Scotland. RBSG is the ultimate parent company of RBSH Group. The consolidated financial statements of RBSH Group are included in the consolidated financial statements of RBSG Group.

*interest is held by Stichting Administratiekantoor Beheer Financiële Instellingen

RBSH Group had total assets of €71.0 billion and owners' equity of €1.8 billion at 31 December 2012. RBSH Group's capital ratios were a Total capital ratio of 19.8%, a Core Tier 1 capital ratio of 11.7% and a Tier 1 capital ratio of 13.9%, as at 31 December 2012.

Organisational structure and business overview

Organisational change

In January 2012, RBSG Group announced changes to its wholesale banking operations in light of a changed market and regulatory environment. The changes saw the reorganisation of the RBSH Group's wholesale businesses into 'Markets' and 'International Banking' and the exit and downsizing of selected activities.

The changes ensure the wholesale businesses continue to deliver against RBSG Group's strategy.

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

The Global Banking & Markets (GBM) and Global Transaction Services (GTS) divisions have been reorganised as follow:

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

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

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

RBSH Group’s activities are organised on a divisional basis as follow:

Markets is a leading origination, sales and trading business across debt finance, fixed income, currencies, investor products and equity derivatives. The division offers a unified service to RBSH Group’s corporate and institutional clients. The Markets’ sales and research teams build strong ongoing client partnerships, provide market perspective and access, and work with the division’s trading and structuring teams to meet the client’s objectives across financing, risk management, investment, securitisation and liquidity.

International Banking serves the world’s largest companies with a leading client proposition focused on financing, transaction services and risk management. International Banking serves as the delivery channel for Markets’ products to corporate clients.

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

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

Business review continued

Description of business continued

Transfers of a substantial part of the business activities of RBS N.V. to RBS plc

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

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

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

It is expected that the Transfers will be completed by 31 December 2013, subject, amongst other matters, to regulatory and other approvals, further tax and other analysis in respect of the assets and liabilities to be transferred and employee consultation procedures. RBS Holdings N.V. has concluded that it will no longer be possible to transfer its businesses in China before conclusion of the Transfers programme at the end of 2013. Consideration is being given to the options for the transfer of businesses in China at a later date. Since the announcement in April 2011, a large portion of the Transfers have already successfully taken place. The transfer of eligible business carried out in the UK, including certain securities issued by RBS N.V. was completed during the last quarter of 2011, the 'UK Transfer', pursuant to Part VII of the UK Financial Services and Markets Act 2000. The UK Transfer moved a large part of the UK Equities & Structured Retail, Markets, Lending and the former GTS businesses as well as part of the UK Non-Core portfolio.

In the first half of 2012, assets and liabilities largely relating to businesses in Singapore, Hong Kong and Kazakhstan were transferred to RBS plc by a combination of local schemes of arrangement, novations and subsidiary share sales.

On 8 August 2012 the Court of Session in Scotland approved the planned transfer of eligible RBS N.V. businesses, including the transfers of certain securities issued by RBS N.V., in the Netherlands and certain EMEA countries to RBS plc on 10 September 2012. The transfer was executed by way of a Dutch statutory demerger (the Demerger) from RBS N.V. into RBS II B.V. (the acquiring company); then onto RBS plc by way of a cross-border merger from RBS II B.V. into RBS plc (the Merger, and together with the Demerger, the Dutch Scheme), after which RBS II B.V. ceased to exist. The Dutch Scheme transferred net assets of €868 million to RBS plc. The Dutch Scheme related largely to Transaction Services business and Lending deals. The Markets business included most Dutch, German and Italian law governed Securitised Products and a number of Over the Counter transactions (OTCs).

Also in the latter half of 2012, other eligible businesses in the Netherlands and certain EMEA countries, and businesses in Malaysia, Turkey and the United Arab Emirates were transferred via novations, market mechanisms and subsidiary share sales.

Included within the Transfers are assets and liabilities that meet the IFRS 5 definition of being Held for Sale as at 31 December 2012. These assets and liabilities, relating largely to businesses in India, Russia, Republic of Korea, Thailand, Indonesia, North America and Romania, have been classified as assets and liabilities of disposal groups as at year end, see Note 19 page 167 for further details.

Certain unaudited pro forma condensed consolidated financial information relating to RBS Holdings N.V. is set out on pages 234-237.

As announced on 19 April 2011, RBSG Group is committed to providing the necessary support to ensure that RBS N.V. continues to meet its commitments during and after the Transfers.

Competition

RBSH Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand has been subdued as many customers have sought to delever and the economy has remained weak.

Competition for corporate and institutional customers in the Netherlands and abroad is from Dutch banks and from large foreign universal banks that offer combined investment and commercial banking capabilities. In addition, RBSH Group's Markets division faces strong competition from dedicated investment banks. In asset finance, RBSH Group competes with banks and specialist asset finance providers, both captive and non-captive. In European and Asian corporate and institutional banking markets RBSH Group competes with the large domestic banks active in these markets and with the major international banks.

Business review continued

Risk factors

Set out below are certain risk factors which could affect RBSH Group's future results and cause them to be materially different from expected results. RBSH Group’s results are also affected by competition and other factors. These risk factors, discussed in more detail in Additional information (pages 243 to 251), should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

- RBSH Group is reliant on the RBSG Group.
- RBSH Group’s businesses and performance can be negatively affected by actual or perceived global economic and financial market conditions.
- RBSH Group has significant exposure to the continuing economic crisis in Europe.
- RBSH Group operates in markets that are highly competitive and its business and results of operations may be adversely affected.
- RBSH Group is subject to other global risks.
- RBSH Group’s earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by depressed asset valuations resulting from poor market conditions.
- The financial performance of RBSH Group has been, and continues to be, materially affected by deteriorations in borrower and counterparty credit quality and further deteriorations could arise due to prevailing economic and market conditions and legal and regulatory developments.
- Changes in interest rates, foreign exchange rates, credit spreads, bond, equity and commodity prices, basis, volatility and correlation risks and other market factors have significantly affected and will continue to affect RBSH Group’s business and results of operations.
- RBSH Group’s ability to meet its obligations including its funding commitments depends on the RBSH Group’s ability to access sources of liquidity and funding.
- RBSH Group’s business performance could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements.
- RBSH Group’s borrowing costs, its access to the debt capital markets and its liquidity depend significantly on its credit ratings.
- The regulatory capital treatment of certain deferred tax assets recognised by RBSH Group depends on there being no adverse changes to regulatory requirements.
- An extensive restructuring and balance sheet reduction programme of the RBSG Group is ongoing and may

adversely affect RBSH Group's business, results of operations, financial condition, capital ratios and liquidity.

- The execution and/or any delay in the execution (or non-completion) of the approved transfers of a substantial part of the business activities of RBS N.V. to RBS plc may have a material adverse effect on RBSH Group.

- As a condition to the RBSG Group receiving HM Treasury support, RBSH Group is prohibited from making discretionary coupon payments on, and exercising call options in relation to, certain of its existing hybrid capital instruments, which may impair RBSH Group's ability to raise new capital through the issuance of securities.

- Each of RBSH Group's businesses is subject to substantial regulation and oversight. Significant regulatory developments and changes in the approach of RBSH Group's key regulators could have a material adverse effect on how RBSH Group conducts its business and on its results of operations and financial condition.

- RBSH Group is subject to a number of legal and regulatory actions and investigations. Unfavourable outcomes in such actions and investigations could have a material adverse effect on RBSH Group's operating results or reputation.

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

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

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

- RBSH Group's operations are highly dependent on its information technology systems.

- RBSH Group may suffer losses due to employee misconduct.

- RBSH Group's operations have inherent reputational risk.

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

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

Business review continued

Key financials

for the year ended 31 December	2012 €m	2011(1) €m	2010(1) €m
Total income	708	4,006	3,890
(Loss)/profit before impairment losses	(822)	1,579	510
Operating (loss)/profit before tax	(887)	(186)	443

Note:
(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

at 31 December		2012 €m	2011 €m(1)	2010 €m(1)
Total assets		70,954	146,776	200,457
Funded balance sheet (2)		63,399	127,638	172,185
Loans and advances to customers		6,380	29,578	44,496
Deposits		37,103	86,121	86,890
Equity attributable to controlling interests		1,799	3,395	4,958
Capital ratios	– Core Tier 1	11.7%	8.6%	8.8%
	– Tier 1	13.9%	12.0%	11.0%
	– Total	19.8%	17.5%	15.8%

Notes:
(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.
(2) Funded balance sheet represents total assets less derivatives.

Business review continued

Summary consolidated income statement

	2012 €m	2011 €m(1)	2010 €m(1)
Net interest income	605	688	1,427
Fees and commissions receivable	469	1,039	1,152
Fees and commissions payable	(198)	(367)	214
Other non-interest (loss)/income	(168)	2,646	1,097
Non-interest income	103	3,318	2,463
Total income	708	4,006	3,890
Operating expenses	(1,530)	(2,427)	(3,380)
(Loss)/profit before impairment losses	(822)	1,579	510
Impairment losses	(65)	(1,765)	(67)
Operating (loss)/profit before tax	(887)	(186)	443
Tax charge	(129)	(449)	(310)
(Loss)/profit from continuing operations	(1,016)	(635)	133
Profit from discontinued operations, net of tax	17	40	985
(Loss)/profit for the year	(999)	(595)	1,118
Attributable to:			
Non-controlling interests	-	-	(2)
Controlling interests	(999)	(595)	1,120

Note:
(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

2012 compared with 2011
Operating loss before tax was €887 million compared with a loss of €186 million in 2011. This decrease of €701 million was due to lower total income partly offset by lower operating expenses and lower impairment losses.

Total income decreased by €3,298 million to a gain of €708 million. This is mainly due to a lower gain in non-interest income.

Net interest income decreased by €83 million to €605 million compared with €688 million in 2011, reflecting further reductions in interest income, in particular in International Banking, mainly due to business transfers to RBS plc.

Non-interest income decreased by €3,215 million to €103 million compared with €3,318 million in 2011, primarily due to the decrease in other non-interest income. This decrease is mainly due to the €2,155 million lower own credit adjustment attributable to the tightening of credit spreads. In addition, fee and trading income were lower as a result of business transfers to RBS plc.

Operating expenses decreased by €897 million to €1,530 million compared with €2,427 million in 2011 due to reduced activities as a result of business transfers to RBS plc.

Impairment losses decreased by €1,700 million to €65 million compared with €1,765 million in 2011. This decrease mainly relates to Greek sovereign available-for-sale bond impairments and related interest rate hedge adjustments, which decreased by €1,428 million, from €1,463 million in 2011 to €35 million in 2012.

Tax

The effective tax rate for 2012 was (14.5%) compared with (241.4%) in 2011. The higher rate for 2011 was mainly the result of losses on Greek sovereign available-for-sale bonds being not recoverable for tax purposes.

Business review continued

2011 compared with 2010

Operating (loss)/profit before tax

Operating loss before tax for the year was €186 million compared with a profit of €443 million in 2010. The decrease largely results from higher impairment losses mainly due to the impairment of Greek sovereign bonds in 2011, which was partially offset by a fair value gain on own debt.

Total income

Total income increased by €116 million to €4,006 million compared with €3,890 million in 2010. This increase is mainly attributable to the fair value gain on own debt resulting in higher other non-interest income. The increase was offset by lower net interest and net fees and commissions' income mainly due to the transfer of businesses to RBS plc and the disposal of Non-Core operations.

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

Non-interest income/(loss) increased by €855 million to €3,318 million compared with €2,463 million in 2010, primarily due to the increase in other operating income. This increase in other operating income is mainly attributable to the widening of credit spreads in the second half of 2011 which led to a fair value gain on own debt of €1,290 million compared with a gain of €250 million in 2010. This increase is partially offset by lower trading income in Markets due to the transfer of trading activities to RBS plc and lower trading income in Non-Core as a result of disposal of operations in Asia and the Americas.

Operating expenses

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

Impairment losses

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

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

Tax

The effective tax rate for 2011 was (241.4)% compared with 70.0% in 2010 mainly as a result of losses on Greek sovereign available-for-sale bonds being not recoverable for tax purposes.

Profit from discontinued operations

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

Business review continued

Analysis of results
Net interest income

	2012	2011	2010
	€m	€m	€m
Interest receivable	1,628	2,352	3,061
Interest payable	(1,023)	(1,664)	(1,634)
Net interest income	605	688	1,427
	%	%	%
Gross yield on interest-earning assets of the banking business (1)	2.1	2.1	2.4
Cost of interest-bearing liabilities of the banking business	(1.4)	(1.5)	(1.3)
Interest spread of the banking business (2)	0.7	0.6	1.1
Benefit from interest-free funds	0.1	0.0	(0.0)
Net interest margin of the banking business (3)	0.8	0.6	1.1

Yields, spreads and margins of the banking business	%	%	%
Gross yield (1)			
– Group	2.1	2.1	2.4
– Domestic	1.4	1.8	1.8
– Foreign	2.8	2.4	3.0
Interest spread (2)			
– Group	0.7	0.6	1.1
– Domestic	(0.1)	(0.1)	0.1
– Foreign	1.6	1.2	2.2
Net interest margin (3)			
– Group	0.8	0.6	1.1
– Domestic	(0.2)	(0.1)	(0.2)
– Foreign	1.8	1.2	2.3

Notes:
(1) Gross yield is the interest rate earned on average interest-earning assets of the banking business.
(2) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
(3) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.

Business review continued

Analysis of results continued
Average balance sheet and related interest

		2012			2011		
		Average balance €m	Interest €m	Rate %	Average balance €m(1)	Interest €m	Rate %
Assets							
Loans and advances to banks	– Domestic	9,870	173	1.8%	4,945	139	2.8%
	– Foreign	15,615	148	0.9%	25,521	207	0.8%
Loans and advances to customers	– Domestic	6,691	154	2.3%	9,234	193	2.1%
	– Foreign	16,677	711	4.3%	28,463	1,058	3.7%
Debt securities	– Domestic	24,274	272	1.1%	34,764	560	1.6%
	– Foreign	4,086	170	4.2%	6,610	195	3.0%
Interest-earning assets	– banking business	77,213	1,628	2.1%	109,537	2,352	2.1%
	– trading business	5,623			19,958		
Interest-earning assets		82,836			129,495		
Non-interest-earning assets		32,904			62,071		
Total assets		115,740			191,566		
Percentage of assets applicable to foreign operations		50.5%			67.5%		
Liabilities							
Deposits by banks	– Domestic	26,210	283	1.1%	23,503	440	1.9%
	– Foreign	15,613	129	0.8%	30,657	125	0.4%
Customer accounts: demand deposits	– Domestic	7,090	60	0.8%	9,853	217	2.2%
	– Foreign	12,900	66	0.5%	21,378	270	1.3%
Customer accounts: savings deposits	– Domestic	-	-	-	209	-	-
	– Foreign	768	28	3.6%	197	5	2.5%
Customer accounts: other time deposits	– Domestic	1,372	44	3.2%	3,394	64	1.9%
	– Foreign	3,767	140	3.7%	5,796	175	3.0%
Debt securities in issue	– Domestic	4,258	63	1.5%	9,613	146	1.5%
	– Foreign	1,038	22	2.1%	3,049	53	1.7%
Subordinated liabilities	– Domestic	4,375	70	1.6%	3,335	79	2.4%
	– Foreign	2,776	162	5.8%	3,281	151	4.6%
Internal funding of trading business	– Domestic	-	-	-	-	-	-
	– Foreign	(4,429)	(44)	1.0%	(3,424)	(61)	1.8%
Interest-bearing liabilities	– banking business	75,738	1,023	1.4%	110,841	1,664	1.5%
	– trading business	11,934			34,431		
Interest-bearing liabilities		87,672			145,272		
Non-interest-bearing liabilities:							

Demand deposits	– Domestic	706	-
	– Foreign	2,084	4,503
Other liabilities		21,466	37,266
Owners' equity		3,812	4,525
Total liabilities and owners' equity		115,740	191,566
Percentage of liabilities applicable to foreign operations		54.9%	68.8%

For notes to this table see page 16.

Business review continued

Analysis of results: Average balance sheet and related interest continued

		2010		
		Average balance €m(1)	Interest €m	Rate %
Assets				
Loans and advances to banks	– Domestic	6,222	165	2.7%
	– Foreign	20,961	192	0.9%
Loans and advances to customers	– Domestic	9,726	362	3.7%
	– Foreign	38,841	1,612	4.2%
Debt securities	– Domestic	42,520	506	1.2%
	– Foreign	6,780	224	3.3%
Interest-earning assets	– banking business	125,050	3,061	2.4%
	– trading business	26,626		
Interest-earning assets		151,676		
Non-interest-earning assets		133,173		
Total assets		284,849		
Percentage of assets applicable to foreign operations		56.7%		
Liabilities				
Deposits by banks	– Domestic	31,277	524	1.7%
	– Foreign	23,552	84	0.4%
Customer accounts: demand deposits	– Domestic	8,051	89	1.1%
	– Foreign	22,386	146	0.7%
Customer accounts: savings deposits	– Domestic	-	-	-
	– Foreign	3,949	69	1.7%
Customer accounts: other time deposits	– Domestic	1,910	46	2.4%
	– Foreign	11,449	277	2.4%
Debt securities in issue	– Domestic	22,406	361	1.6%
	– Foreign	4,382	124	2.8%
Subordinated liabilities	– Domestic	4,747	110	2.3%
	– Foreign	2,855	(98)	(3.4%)
Internal funding of trading business	– Domestic	-	-	-
	– Foreign	(6,941)	(98)	1.4%
Interest-bearing liabilities	– banking business	130,023	1,634	1.3%
	– trading business	38,989		
Interest-bearing liabilities		169,012		
Non-interest-bearing liabilities:				
Demand deposits	– Domestic	990		

	– Foreign	2,465
Other liabilities		106,099
Owners' equity		6,283
Total liabilities and owners' equity		284,849
Percentage of liabilities applicable to foreign operations		56.1%

Notes:

(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

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

Business review continued

Analysis of results continued

Analysis of change in net interest income – volume and rate analysis

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

	2012 over 2011 Increase/(decrease) due to changes in:		
	Average volume €m	Average rate €m	Net change €m
Interest-earning assets			
Loans and advances to banks			
Domestic	101	(67)	34
Foreign	(90)	31	(59)
Loans and advances to customers			
Domestic	(57)	18	(39)
Foreign	(486)	139	(347)
Debt securities			
Domestic	(143)	(145)	(288)
Foreign	(89)	64	(25)
Total interest receivable of the banking business			
Domestic	(99)	(194)	(293)
Foreign	(665)	234	(431)
	(764)	40	(724)
Interest-bearing liabilities			
Deposits by banks			
Domestic	(46)	203	157
Foreign	82	(86)	(4)
Customer accounts: demand deposits			
Domestic	49	108	157
Foreign	82	122	204
Customer accounts: savings deposits			
Domestic	-	-	-
Foreign	(20)	(3)	(23)
Customer accounts: other time deposits			
Domestic	50	(30)	20
Foreign	70	(35)	35
Debt securities in issue			
Domestic	79	4	83
Foreign	41	(10)	31
Subordinated liabilities			

Domestic	(26)	35	9
Foreign	23	(34)	(11)
Internal funding of trading business			
Domestic	-	-	-
Foreign	15	(32)	(17)
Total interest payable of the banking business			
Domestic	106	320	426
Foreign	293	(78)	215
	399	242	641
Movement in net interest income			
Domestic	7	126	133
Foreign	(372)	156	(216)
	(365)	282	(83)

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

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Business review continued

Analysis of results: Analysis of change in net interest income – volume and rate analysis continued

	2011 over 2010 Increase/(decrease) due to changes in:		
	Average volume €m	Average rate €m	Net change €m
Interest-earning assets			
Loans and advances to banks			
Domestic	(35)	9	(26)
Foreign	39	(24)	15
Loans and advances to customers			
Domestic	(17)	(152)	(169)
Foreign	(398)	(156)	(554)
Debt securities			
Domestic	(103)	157	54
Foreign	(6)	(23)	(29)
Total interest receivable of the banking business			
Domestic	(155)	14	(141)
Foreign	(365)	(203)	(568)
	(520)	(189)	(709)
Interest-bearing liabilities			
Deposits by banks			
Domestic	141	(57)	84
Foreign	(28)	(13)	(41)
Customer accounts: demand deposits			
Domestic	(24)	(104)	(128)
Foreign	7	(131)	(124)
Customer accounts: savings deposits			
Domestic	-	-	-
Foreign	86	(22)	64
Customer accounts: other time deposits			
Domestic	(30)	12	(18)
Foreign	159	(57)	102
Debt securities in issue			
Domestic	195	20	215
Foreign	31	40	71
Subordinated liabilities			
Domestic	33	(2)	31
Foreign	13	(262)	(249)
Internal funding of trading business			
Domestic	-	-	-

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

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

Business review continued

Divisional performance

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

	2012	2011	2010
Operating (loss)/profit before tax	€m	€m(1)	€m(1)
Markets	(503)	1,342	383
International Banking	182	81	409
Central items	(535)	(1,270)	40
Core	(856)	153	832
Non-Core	(31)	(339)	(389)
	(887)	(186)	443

Note:

(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

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

	2012	2011	2010
Markets	2,900	5,900	6,100
International Banking	5,500	7,000	6,100
Central items	300	600	700
Core	8,700	13,500	12,900
Non-Core	2,600	4,200	6,400
	11,300	17,700	19,300

Business review continued

Divisional performance continued
Markets

	2012	2011	2010
	€m	€m	€m
Net interest income	142	66	201
Non-interest income	70	2,589	1,719
Total income	212	2,655	1,920
Direct expenses			
– staff costs	(363)	(696)	(892)
– other	(318)	(511)	(668)
Indirect expenses	1	(53)	27
	(680)	(1,260)	(1,533)
(Loss)/profit before impairment losses	(468)	1,395	387
Impairment losses	(35)	(53)	(4)
Operating (loss)/profit before tax	(503)	1,342	383
	€bn	€bn	€bn
Balance sheet			
Third party assets	30	72	112
Third party liabilities	36	77	120

2012 compared with 2011
Operating loss before tax was €503 million compared with a gain of €1,342 million in 2011. This decrease of €1,845 million was mainly due to lower total income partly offset by lower operating expenses.

Total income decreased by €2,443 million to €212 million mainly attributable to the decrease in non-interest income.

Net interest income increased by €76 million to €142 million compared with €66 million in 2011. This reflects lower funding costs after the transfer of businesses to RBS plc.

Non-interest income decreased by €2,519 million to €70 million in 2012 compared with €2,589 million in 2011, primarily due to the €1,602 million decrease in other operating income. This is mainly due to the €1,390 million lower own credit adjustment attributable to the tightening of credit spreads. The remaining decrease in other operating income is largely due to a lower gain on the currency translation reserve release related to the transfer of businesses to RBS plc of €167 million compared to €404 million in 2011. In addition, fee and trading income were €893 million lower as a result of transfer of businesses to RBS plc.

Operating expenses have decreased by €580 million to €680 million compared with €1,260 million in 2011. This reflects the continuing transfer of businesses to RBS plc.

Impairment losses decreased by €18 million to €35 million compared with €53 million in 2011. The impairments in 2012 and 2011 reflect a small number of single name provisions.

2011 compared with 2010
Operating profit before tax was €1,342 million compared with €383 million for 2010.

Total income increased by €735 million to €2,655 million. The increase is mainly attributable to the increase in non-interest income due to a fair value gain on own debt which is only partially offset by lower net interest income.

Net interest income decreased by €135 million to €66 million compared with €201 million in 2010, reflecting further reductions in interest earning assets due to transfers to RBS plc.

Non-interest income increased by €870 million to €2,589 million in 2011 compared with €1,719 million in 2010. The increase in other operating income is mainly attributable to the widening of credit spreads in the second half of 2011 which led to a fair value gain on own debt of €879 million compared to a gain of €252 million in 2010. In addition the 2011 results benefited from a gain on a currency translation reserve release of €404 million as a result of the transfer of activities to RBS plc. This increase is partially offset by lower income from trading activities due to the transfer of trading activities to RBS plc and depressed primary market volumes, characterised by volatile and deteriorating credit markets, especially during the second half of the year when the European sovereign debt crisis drove a sharp widening in credit spreads. The heightened volatility increased risk aversion amongst clients and limited opportunities for revenue generation in the secondary markets.

Operating expenses have decreased by €273 million to €1,260 million compared with €1,533 million in 2010. This reflects the transfer of businesses to RBS plc, thus reducing the scale of operations in 2011.

Impairments losses were €53 million in 2011 compared with €4 million in 2010. The impairments in 2011 reflect a small number of single name provisions.

Business review continued

Divisional performance continued
International Banking

	2012	2011	2010
	€m	€m	€m
Net interest income	280	490	556
Non-interest income	444	548	510
Total income	724	1,038	1,066
Direct expenses			
– staff	(239)	(323)	(357)
– other	(339)	(455)	(402)
Indirect expenses	12	33	-
	(566)	(745)	(759)
(Loss)/profit before impairment losses	158	293	307
Impairment recoveries/(losses)	24	(212)	102
Operating profit before tax	182	81	409
	€bn	€bn	€bn
Balance sheet			
Third party assets	4	24	30
Third party liabilities	7	35	41

2012 compared with 2011
Operating profit before tax was €182 million compared with €81 million in 2011. This increase of €101 million was mainly due to lower operating expense and higher impairment recoveries partly offset by lower total income.

Total income decreased by €314 million to €724 million due to decreases in both net interest income and non-interest income.

Net interest income decreased by €210 million to €280 million compared with €490 million in 2011. This reflects further reductions in lending mainly due to the transfer of businesses to RBS plc.

Non-interest income decreased by €104 million to €444 million compared with €548 million in 2011. This is mainly attributable to the transfer of businesses to RBS plc.

Operating expenses decreased by €179 to €566 million compared with €745 million in 2011 as a result of the transfer of businesses to RBS plc.

Impairment losses decreased by €236 million to a recovery of €24 million compared with a loss of €212 million in 2011. The impairments in 2011 are largely driven by a single name provision.

2011 compared with 2010

Operating profit before tax was €81 million compared with €409 million in 2010.

Total income decreased by €28 million to €1,038 million with a decrease in net interest income, partially offset by an increase in non-interest income.

Net interest income decreased by €66 million to €490 million compared with €556 million in 2010, reflecting further reductions in interest earning assets due to transfers to RBS plc.

The increase in non-interest income by €38 million to €548 million compared with €510 million in 2010 is mainly attributable to an increase of transactional exchange rate fees.

Impairment losses were €212 million compared with a credit of €102 million in 2010. The impairments in 2011 are largely driven by a single name provision. The impairments in 2010 reflect a small number of single name provisions, mainly on APS back-to-back covered assets, which are more than offset by several recoveries following the renegotiation of impaired exposures.

Business review continued

Divisional performance continued
Central Items

	2012	2011	2010
	€m	€m	€m
Net interest (loss)/income	(34)	(110)	43
Non-interest (loss)/income	(396)	407	301
Total (loss)/income	(430)	297	344
Direct expenses			
– staff	(62)	(69)	(216)
– other	(17)	(49)	(71)
Indirect expenses	(3)	14	(17)
	(82)	(104)	(304)
(Loss)/profit before impairment losses	(512)	193	40
Impairment losses	(23)	(1,463)	-
Operating (loss)/profit before tax	(535)	(1,270)	40
	€bn	€bn	€bn
Balance sheet			
Third party assets	29	39	38
Third party liabilities	20	25	21

2012 compared with 2011
Operating loss before tax was €535 million compared with a loss of €1,270 million in 2011. The reduced loss is largely due to lower impairment losses partly offset by lower total income.

Total income decreased by €727 million to a loss of €430 million, mainly reflecting lower non-interest income.

Net interest income increased by €76 million to a loss of €34 million. This mainly reflects the lower funding costs as a result of third party funding being replaced by funding from RBS plc as part of the transfer of business to RBS plc.

Non-interest income decreased by €803 million to a loss of €396 million compared with a gain of €407 million in 2011 primarily due to the decrease in other operating income. This is mainly due to the €765 million lower own credit adjustment attributable to the tightening of credit spreads.

Operating expenses decreased by €22 million to €82 million compared with €104 in 2011 due to a litigation recovery.

Impairment losses decreased by €1,440 million to €23 million compared with €1,463 million in 2011. This decrease mainly relates to Greek sovereign available-for-sale bonds impairments and related interest rate hedge adjustments, which decreased by €1,427 million, from €1,462 million in 2011 to €35 million in 2012.

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

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

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

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

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

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

Business review continued

Divisional performance continued
Non-Core

	2012	2011	2010
	€m	€m(1)	€m(1)
Net interest income	217	242	627
Non-interest loss	(15)	(226)	(67)
Total income	202	16	560
Direct expenses			
– staff	(77)	(122)	(310)
– other	(115)	(197)	(462)
Indirect expenses	(10)	1	(12)
	(202)	(318)	(784)
Profit/(loss) before other operating charges and impairment losses	-	(302)	(224)
Impairment losses	(31)	(37)	(165)
Operating loss before tax	(31)	(339)	(389)
	€bn	€bn	€bn
Balance sheet			
Third party assets	8	12	19
Third party liabilities	5	7	16

Note:
(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

2012 compared with 2011
Operating loss before tax was €31 million compared with a loss of €339 million in 2011, largely due to higher total income, lower expenses and lower impairment losses.

Total income increased by €186 million to €202 million mainly due to a lower loss in non-interest income.

Net interest income decreased by €25 million to €217 million compared with €242 million in 2011 following the continuing Non-Core disposals.

Non-interest income increased by €211 million to a loss of €15 million compared to a loss of €226 million in 2011. The increase is mainly due to lower losses on sale and revaluation of assets compared to 2011.

Operating expenses decreased by €116 million to €202 million compared with €318 million in 2011. Operating expenses decreased following the continuing Non-Core disposals.

Impairment losses decreased by €6 million to a loss of €31 million compared with a loss of €37 million in 2011.

2011 compared with 2010
Operating loss before tax was €339 million compared with a loss of €389 million in the year 2010.

Total income decreased by €544 million to €16 million. This is mainly due to lower net interest income, net fees and commissions' income and income from trading activities which is partly offset by an increase in other operating income.

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

Non-interest income decreased by €159 million to a loss of €226 million compared to a loss of €67 million in 2010. The decrease is mainly due to lower fees and commissions' income and income from trading activities as a result of the disposal of operations in Asia and the Americas. The decrease was partly offset by the increase in other operating income due to lower losses on sale and revaluation of assets compared to 2010, as well as the true-up of the APS back-to-back premium of €85 million, see page 99 of this report for further details.

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

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

Business review continued

Consolidated balance sheet at 31 December 2012

	2012	2011	2010
	€m	€m(1)	€m(1)
Assets			
Cash and balances at central banks	2,294	12,609	8,323
Net loans and advances to banks	15,087	17,953	22,433
Reverse repurchase agreements and stock borrowing	68	9,100	4,272
Loans and advances to banks	15,155	27,053	26,705
Net loans and advances to customers	6,375	29,295	40,608
Reverse repurchase agreements and stock borrowing	5	283	3,888
Loans and advances to customers	6,380	29,578	44,496
Debt securities	22,655	39,645	52,260
Equity shares	1,127	3,093	22,634
Settlement balances	31	2,608	3,573
Derivatives	7,555	19,138	28,272
Intangible assets	49	115	199
Property, plant and equipment	15	152	283
Deferred tax	420	444	5,440
Prepayments, accrued income and other assets	1,469	5,646	5,912
Assets of disposal groups	13,804	6,695	2,360
Total assets	70,954	146,776	200,457
Liabilities			
Bank deposits	21,841	29,988	27,178
Repurchase agreements and stock lending	12,624	16,532	4,807
Deposits by banks	34,465	46,520	31,985
Customers deposits	2,620	38,842	49,886
Repurchase agreements and stock lending	18	759	5,019
Customer accounts	2,638	39,601	54,905
Debt securities in issue	2,602	17,714	53,411
Settlement balances and short positions	107	3,409	5,202
Derivatives	9,644	19,868	35,673
Accruals, deferred income and other liabilities	1,782	3,835	5,213
Retirement benefit liabilities	-	60	75
Deferred tax	40	201	260
Subordinated liabilities	6,851	6,859	6,894
Liabilities of disposal groups	11,026	5,293	1,857
Total liabilities	69,155	143,360	195,475
Non-controlling interests	-	21	24
Controlling interests	1,799	3,395	4,958
Total equity	1,799	3,416	4,982

Total liabilities and equity	70,954	146,776	200,457

Note:

(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

Business review continued

Commentary on consolidated balance sheet 2012 compared with 2011
Total assets were €71.0 billion at 31 December 2012, a decrease of €75.8 billion, or 52%, when compared with €146.8 billion at 31 December 2011.

Cash and balances at central banks decreased by €10.3 billion or 82% to €2.3 billion at 31 December 2012 compared with €12.6 billion at 31 December 2011 principally due to reduced liquidity requirements following the transfer of business to RBS plc during the year, in particular the Dutch Scheme. In addition the decrease is due to the 2013 Transfers being classified as assets of disposal groups (€3.5 billion).

Loans and advances to banks decreased by €11.9 billion, or 44%, to €15.1 billion at 31 December 2012 compared with €27.1 billion at 31 December 2011 principally due the transfer of business to RBS plc during the year, in particular the Dutch Scheme. In addition the decrease is due to the 2013 Transfers being classified as assets of disposal groups (€1.2 billion) and a decline in bank placings.

Loans and advances to customers declined €23.2 billion, or 78%, to €6.4 billion. Customer lending decreased by €22.9 billion, or 78%, to €6.4 billion. This reflected the transfer of business to RBS plc during the year, in particular the International Banking businesses included within the Dutch Scheme. In addition the decrease is due to the 2013 Transfers being classified as assets of disposal groups (€2.3 billion).

Debt securities decreased by €17.0 billion to €22.7 billion, reflecting a reduction in holdings of eurozone government and financial institution bonds (€9.8 billion), the transfer of business to RBS plc as part of the Dutch Scheme and due to the 2013 Transfers being classified as assets of disposal groups (€2.7 billion).

Equity shares decreased by €2.0 billion, to €1.1 billion. This reflected the transfer of business to RBS plc as part of the Dutch Scheme.

Derivative assets decreased by €11.6 billion, or 61%, to €7.6 billion at 31 December 2012 compared with €19.1 billion at 31 December 2011. Derivative liabilities decreased by €10.2 billion, or 52%, to €9.6 billion at 31 December 2012 compared to the balance of €19.9 billion at 31 December 2011. This was largely attributable to the transfer of business to RBS plc as part of the Dutch Scheme.

The increase in assets and liabilities of disposal groups is due to the inclusion of the 2013 Transfers. These businesses are part of the Transfers for 2013 that meet the IFRS 5 definition of being held for disposal as at 31 December 2012, see Note 19 page 167 for further details.

Total liabilities were €69.2 billion as at 31 December 2012, a decrease of €74.2 billion, or 52%, when compared with €143.4 billion at 31 December 2011.

Deposits by banks decreased by €12.1 billion, or 26%, to €34.5 billion, with lower repurchase agreements and stock lending (repos), down €3.9 billion, 24%, to €12.6 billion. This reduction is mainly due to the transfer of businesses to RBS plc during the year, in particular the Dutch Scheme. In addition the decrease is due to the downsizing of the fiduciary business in Markets and planned reductions in funding from RBS plc. This was partially offset by an increase in funding provided by the European Central Bank’s Long Term Refinancing Operation (LTRO).

Customer accounts were down €37.0 billion, or 93%, to €2.6 billion, mainly due to the transfer of business to RBS plc during the year, in particular the Dutch Scheme.

Debt securities in issue declined €15.1 billion, or 85%, to €2.6 billion, largely as a result of the transfer of business to RBS plc during the year, in particular the Dutch Scheme and a decrease in notes and commercial paper outstanding reflecting positions maturing in Markets and Group Treasury.

Equity decreased by €1.6 billion, or 47%, to €1.8 billion, largely driven by the Dutch Scheme.

Business review continued

Commentary on consolidated balance sheet 2011 compared with 2010
Total assets were €146.8 billion at 31 December 2011, a decrease of €53.7 billion, or 27%, when compared with €200.5 billion at 31 December 2010.

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

Loans and advances to banks increased by €0.4 billion, or 1%, to €27.1 billion at 31 December 2011 compared with €26.7 billion at 31 December 2010. Within this, reverse repurchase agreements and stock borrowing (reverse repos) were up €4.8 billion, 113%, to €9.1 billion primarily as a result of the investment of surplus liquidity in short-term assets. Bank placings declined by €4.4 billion, 20%, to €18.0 billion, as a result of lower current accounts and time deposits in Markets.

Loans and advances to customers declined €14.9 billion, or 34%, to €29.6 billion. Within this, reverse repurchase agreements were down €3.6 billion, 93%, to €0.3 billion. Customer lending decreased by €11.3 billion, or 28%, to €29.3 billion. This reflected the planned reductions in the last quarter of 2011 in relation to the UK transfers, see page 9 for further details, along with declines in the Netherlands Markets and International banking businesses. Provisions as a percentage of gross loans and advances to customers increased from 3.3% to 4.9%. This was largely driven by a single name provision in 2011, refer to pages 74 and 159 for further analysis of provisions.

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

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

Derivative assets decreased by €9.2 billion, or 32%, to €19.1 billion at 31 December 2011 compared with €28.3 billion at 31 December 2010. Derivative liabilities decreased by €15.8 billion, or 44%, to €19.9 billion at 31 December 2011 compared to the balance of €35.7 billion at 31 December 2010. This was largely attributable to the planned reductions in the last quarter of 2011 in relation to the UK transfers and the lower volume of over the counter traded derivatives.

The increase in assets and liabilities of disposal groups is due to the inclusion of assets and liabilities relating largely to businesses in Singapore, Australia and Kazakhstan. These businesses are part of the Proposed Transfers for 2012 that meet the IFRS 5 definition of being held for disposal as at 31 December 2011, see Note 19 page 167 for further details.

Total liabilities were €143.4 billion as at 31 December 2011, a decrease of €52.1 billion, or 27%, when compared with €195.5 billion at 31 December 2010.

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

Customer accounts were down €15.3 billion, or 28%, to €39.6 billion. Within this, repos decreased €4.2 billion, or 85%, to €0.8 billion. Excluding repos, customer deposits were down €11.1 billion, or 22%, at €38.8 billion. This reflected the planned reductions in the last quarter of 2011 in relation to the UK transfers (see page 9 for further details), along with the maturing of time deposits in the US and lower demand accounts in Markets businesses.

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

Equity decreased by €1.6 billion, or 31%, to €3.4 billion, driven by the attributable loss for the period of €0.6 billion and decreases in foreign exchange reserves of €0.4 billion reflecting gains recycled to profit and loss due to the UK Transfers, and a decrease in available-for-sale reserves of €0.4 billion. The decrease in available-for-sale reserves was due to the derecognition of the related deferred tax assets and fair value movements on available-for-sale securities which was partly offset by the recycling of the cumulative losses on RBSH Group's holding of Greek government bonds, that were recycled to profit and loss in the first half of 2011.

Business review Risk and balance sheet management

Risk principles

Introduction

Risk and balance sheet management are conducted on an overall basis within RBSG Group. Therefore the discussion on risk and balance sheet management on pages 27 to 101 refers principally to policies and procedures in RBSG Group that also apply to RBSH Group.

Strategic objectives

Risk management plays an integral role in the delivery of RBSG Group's strategic goal to be a safe and secure banking group.

In 2009 RBSG Group's Board set out four key strategic risk objectives, aligned to RBSG Group's Strategic Plan. These are to:

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

These strategic risk objectives are the bridge between the RBSG Group-level business strategy and the frameworks, limits and tolerances that are used to set risk appetite and manage risk in the business divisions on a day-to-day basis. In addition, these strategic risk objectives are the driving force behind the continued focus on de-risking RBSH Group through the Transfers to RBS plc.

This is how we bring the Strategic Plan to life in our management of risk.

More detailed discussions on how RBSH Group strengthened its approach to risk management in 2012 and the areas of focus going forward is contained within the relevant sub-sections on the following pages.

Risk appetite and risk governance

Risk appetite

RBSH Group's risk appetite identifies and establishes the level and type of risks that it is able and willing to take in executing its chosen business strategy, to protect itself against events that may have an adverse impact on its profitability and/or its capital base. RBSH Group has developed a framework that sets and implements an appropriate risk appetite supported by a regular monitoring and review process. A risk appetite statement setting out overall risk limits for different risk types is approved by the Supervisory Board. Risk appetite limits and risk exposures are reported monthly to the Risk and Control Committee (RCC), the Managing Board and the Supervisory Board. Any limit breach is reported to the Managing Board. The Managing Board may grant a temporary waiver or require the position to be adjusted to comply with the risk limit. For limits other than risk appetite limits authority has been delegated to the RCC, the Asset and Liability Committee (ALCO) and, for certain market risk limits, the Head of Market Risk. The RBS NV RCC and ALCO each have three or more Managing Board members.

A range of different but complementary tools have been developed to measure whether strategic plans are consistent with risk appetite, to test broader 'what if' questions and to assess the impact of changes in key assumptions:

- Integrated stress testing - Stress testing forms part of RBSH Group's risk and capital management framework and is a major component of the Basel III requirements. It highlights to senior management potential adverse unexpected outcomes related to a mixture of risks and provides an indication of how much capital might be required to absorb losses should adverse scenarios materialise. Stress testing was utilised as a key decision making and capital planning tool as part of the planning of the transfer of a substantial part of the business activities of RBS N.V. to RBS plc.

- Economic capital - provides complementary insights, with a breadth of understanding of risk profile changes and 'tail risks' across different modelled scenarios.

- Sensitivity analysis - provides 'ready reckoners' around changes in key variables. It provides a high-level view on 'what if' questions.

RBSG Group Policy Framework

The RBSG Group Policy Framework (GPF) provides clear guidance and controls on how RBSG Group does business, its business conduct and compliance responsibilities and its focus on delivering a control environment.

The GPF and related initiatives aim to ensure that:

- RBSG Group has clear control standards and ethical principles to cover the risks that it faces to support effective risk management and meet regulatory and legal requirements;

Business review Risk and balance sheet management continued

Risk appetite and risk governance: Risk appetite continued

- Policies are followed across RBSG Group and compliance can be clearly evidenced, assessed and reported by line management; and

- The control environment is monitored and overseen through good governance.

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

The GPF was introduced in 2009, key developments during 2012 included:

- Following external benchmarking exercises, new policy standards were introduced setting out the mandatory controls required to mitigate key risks to RBSG Group.

- A conduct risk framework was agreed and is being progressively established. Grouped under four policy standards: employee conduct, corporate conduct, market conduct; and conduct towards our customers, each is designed to provide high level direction to RBSG Group and is supported by RBSG Group's Code of Conduct (refer to page 109 for more detail).

- RBSG Group's key credit risk policies and mandatory controls were restructured and realigned to reflect credit risk of wholesale and retail. These changes are aimed at simplifying the policy structure and making it clearer to divisions which standards are applicable to their respective businesses.

- Certain procedural-related policy standards were removed from the framework to reduce bureaucracy and simplify the structure.

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

Risk governance

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

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

Notes:
(1)The RBSG Group Risk Committee and the GALCO report directly to the RBSG Executive Risk Forum.
(2)The RBSG Capital and Stress Testing Committee is a sub-committee of the GALCO.

Risk appetite and risk governance: Risk governance continued

Board/Committee	Risk focus	Membership
Supervisory Board	The Supervisory Board is responsible for supervising RBSH Group's management, RBSH Group's general affairs, the business connected with it and for advising the Managing Board.	Consists of five members. Three members are executives of RBSG Group.
Managing Board	Reports to RBSH Group Supervisory Board and is the principal decision making forum for RBSH Group. It approves strategy, including the strategies for each of the principal businesses, and monitors the performance of the principal businesses. It also reviews acquisitions, disposals and other significant transactions, is responsible for capital entry management and allocation and determines dividend policy.	The Managing Board comprises of at least five members including the Chairman, one Vice-Chairman and the Chief Financial Officer (CFO).
Risk & Audit Committee (R&A Cte)	A sub-committee of the Supervisory Board. The RBSH Group Risk & Audit Committee is responsible for the review of all matters relative to accounting policies, internal control, financial reporting functions, internal audit, external audit, risk assessment and regulatory compliance and it assists on such other matters as may be referred to it by the RBSH Group Supervisory Board and or the RBSG Group Audit Committee.	The members of the RBSH Group R&A Cte are appointed by the Supervisory Board from its own members.
Asset & Liability Committee (ALCO)	A sub-committee of the Managing Board. ALCO is responsible for identifying, managing and controlling RBSH Group balance sheet risks in executing its business strategy, with specific focus on the management of capital, liquidity, interest rate risk and foreign exchange risk.	Seven permanent voting members led by the Chairman of the Managing Board, RBSH Group CFO, RBSH Group Chief Administration officer (CAO), RBSH Group Chief Risk Officer (CRO), RBSH Group Treasurer also RBSG Group EMEA Treasurer, RBSG Group International Banking Chief Logistics Officer and RBSG Group Markets & International Banking Treasurer Permanent non-voting guests:

		RBSG Group Non-Core Treasurer, RBSG Group Global Head of Equity
Risk and Control Committee (RCC)	A sub-committee of the Managing Board. The RBSH Group Risk and Control Committee oversees the risk framework within RBSH Group, monitors the actual risk profile and advises the Managing Board. Its scope is credit, market, operational and regulatory risk within RBSH Group.	Chaired by the RBSH Group CRO, Members include RBSH Group Head of Credit Risk, RBSH Group Head Risk Office, RBSH Group CFO, RBSH Group CAO, RBSH Group Head of Markets, RBSH Group Head of International Banking, RBSH Group Head of Market Risk, RBSH Group Head of Operational, RBSH Group Head of Regulatory Risk and Compliance, RBSH Group Head of Non-Core Risk, RBSH Group CRO M&IB EMEA, RBSH Group CRO Asia Pacific, RBSH Group CRO Americas.

Business review Risk and balance sheet management continued

Risk appetite and risk governance continued
Risk coverage
The main risk types faced by RBSH Group are presented below, together with a summary of the key areas of focus and how RBSH Group managed these risks in 2012.

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2012
Capital adequacy risk	The risk that RBSH Group has insufficient capital.	Potential to disrupt the business model and stop normal functions of RBSH Group. Potential to cause RBSH Group to fail to meet the supervisory requirements of regulators. Significantly driven by credit risk losses and the transfer of a substantial part of the business activities of RBS N.V. to RBS plc.	RBSH Group plans for and maintains an adequate amount and mix of capital consistent with its risk profile. The amount of capital required is determined through risk assessments and stress testing.
Funding and liquidity risk	The risk that RBSH Group is unable to meet its financial liabilities as they fall due.		RBSH Group's performance in 2012 represented a new benchmark in the management of liquidity risk as RBSH Group began operating under normalised market practices for the management of funding and liquidity risk, despite a backdrop of continued market uncertainty and certain RBSH Group specific factors such as a downgrade of RBSH Group's external credit rating.
Credit risk (including counterparty credit risk)	The risk that RBSH Group will incur losses owing to the failure of a customer to meet its obligation to settle outstanding amounts.	Loss characteristics vary materially across portfolios. Significant link between losses and the	RBSH Group manages credit risk based on a suite of credit approval and risk concentration frameworks and associated risk management systems and tools. It also continues to reduce the risk associated

macroeconomic environment. Can include concentration risk - the risk of loss due to the concentration of credit risk to a specific product/asset class, sector or counterparty.	with legacy exposures through further reductions in Non-Core assets.

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Risk appetite and risk governance: Risk coverage continued

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2012
Country risk	The risk of material losses arising from significant country-specific events.	Can arise from sovereign events, economic events, political events, natural disasters or conflicts. Potential to affect parts of RBSH Group's credit portfolio that are directly or indirectly linked to the country in question.	All country exposures are covered by RBSG Group's country risk management framework. All countries with material exposures are monitored continually using RBSG Group's country risk watchlist process to identify emerging issues and facilitate the development of mitigation strategies. Portfolio reviews are undertaken to align to RBSG Group's country risk appetite in light of evolving economic and political developments. Sovereign risk increased further in 2012, resulting in rating downgrades for a number of countries, mostly in the eurozone. After the impairment charge in 2011, RBSH Group participated in the restructuring of Greek sovereign debt in the first quarter of 2012 and no longer holds available-for-sale Greek government bonds. During 2012, RBSG Group brought nearly all advanced countries under country limit control and further strengthened its country risk appetite setting. This contributed to a further reduction in exposure to a range of countries.
Market risk	The risk arising from changes in interest rates, foreign currency, credit spreads, equity prices and risk related factors such as market volatilities.	Frequent small losses which are material in aggregate. Infrequent large material losses due to stress events.	A comprehensive structure is in place aimed at ensuring RBSH Group does not exceed its qualitative and quantitative tolerance for market risk. RBSG Group's market risk policy statements set out its qualitative tolerance for market risk. They define the governance, responsibilities and requirements for the identification, measurement, analysis, management and communication of the market risk arising from RBSH Group's trading and non-trading investment activities.

			The RBSG Group Market Risk limit framework expresses the RBSG Group's quantitative tolerance for market risk. The RBSG Group limit metrics capture, in broad terms, the full range of market risk exposures, ensuring the risk is appropriately defined and communicated.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Frequent small losses. Infrequent material losses.	RBSG Group aims to manage operational risk to an acceptable level by taking into account the cost of minimising the risk against the resultant reduction in exposure. During 2012, RBSG Group continued to make good progress in enhancing its operational risk framework and risk management capabilities. Key areas of focus have included: embedding risk assessments; increasing the coverage of the scenario analysis portfolio; and improving statistical capital modeling capabilities. The level of operational risk remains high due to the scale of change occurring across RBSH Group, both structural and regulatory, macroeconomic stresses (e.g. eurozone distress) and other external threats such as e-crime.

Business review Risk and balance sheet management continued

Risk appetite and risk governance: Risk coverage continued

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2012
Regulatory risk	The risk arising from non-compliance with regulatory requirements, regulatory change or regulator expectations.	Adverse impacts on strategy, capital structure, business models and operational effectiveness. Financial cost of adapting to changes in laws, rules or regulations or of penalties for non-compliance. Financial cost and reputational damage in respect of penalties for non-compliance/breach of regulations.	Management of regulatory risk entails early identification and effective management of changes in legislative and regulatory requirements that may affect RBSH Group. Within the RBSG Group Policy Framework, specific policies define the minimum standards for regulatory engagement, upstream risk management and registration and licensing of individuals. These set minimum standards within their respective areas, applicable across RBSG Group. During 2012, RBSG Group, along with the rest of the banking industry, continued to experience unprecedented levels of prospective changes to laws and regulations from national and supranational regulators. Particular areas of focus were: conduct regulation; prudential regulation (capital, liquidity, governance and risk management); treatment of systemically important entities (systemic capital surcharges and recovery and resolution planning); and structural reforms, with the UK's Independent Commission on Banking proposals, the European Union's Liikanen Group recommendations and the Dodd-Frank/Volcker Rule measures in the US.
Conduct risk	The risk that the conduct of RBSH Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss.	Arises from breaches of regulatory rules or laws by individual employees, or as a result of RBSH Group's retail or wholesale market conduct.	A defined and measurable appetite for conduct risk has been established to ensure commercial decisions take account of conduct risk implications. A framework has been developed and agreed to enable the identification, assessment and mitigation of conduct risks and resultant issues. Embedding of this framework started during

		It may also arise from the failure to meet customers' or regulators' expectations of RBSH Group. Non-compliance may result in regulator enforcement, adverse publicity and financial penalties.	2012 and is continuing in 2013. Grouped under four pillars (employee conduct, corporate conduct, market conduct and conduct towards RBSG Group's customers), each conduct risk policy is designed to provide both high-level direction and Group-wide requirements. Awareness initiatives and targeted conduct risk training for each policy, aligned to the phased policy roll-out, have been developed and are being delivered to help embed understanding and provide the necessary clarity.
Reputational risk	The risk of brand damage arising from financial and non-financial losses due to failure to meet stakeholders' expectations of RBSH Group's conduct and performance.	Can arise from a range of actions taken (or, in some cases, not taken) by RBSH Group, as well as its wider conduct, policies and practices. Can be detrimental to the business in a number of ways, including an inability to build or sustain customer relationships, low staff morale or reduced access to funding sources.	The Managing Board has ultimate responsibility for managing RBSH Group's reputation, although all parts of RBSH Group have responsibility for any reputational impact arising from their operations. The Managing Board's oversight is supported by the RBSG Group Board and the RBSG Group executive risk committees (including a new RBSG Group Conduct Risk Committee) and by the RBSG Group Sustainability Committee. In 2012, RBSG Group strengthened the alignment of reputational risk management with its strategic objective of serving customers well and with the management of a range of risk types that have a reputational sensitivity.

Business review Risk and balance sheet management continued

Risk appetite and risk governance: Risk coverage continued

Risk type	Definition	Features	How RBSH Group manages risk and the progress in 2012
Business risk	The risk of losses as a result of adverse variance in RBSH Group's revenues and/or costs relative to its business plan and strategy.	Influenced by many factors such as pricing, sales volumes and input costs, strategic decisions and/or by external factors such as exposure to macroeconomic, regulatory and industry risks.	Business risk is identified, measured and managed through RBSH Group's planning cycles and performance management processes. RBSH Group operates a rolling forecast process which identifies projected changes in or risks to operating profit and ensures appropriate actions are taken. The management of business risk lies primarily with divisions, with oversight at RBSH Group level led by Finance. During 2012, there was a focus on building better cost management capability across RBSH Group, in response to the changing business environment. RBSH Group has further enhanced its scenario modeling to better understand potential threats to earnings and, thus, develop contingency plans.
Pension risk	The risk that RBSH Group may have to make additional contributions to its defined benefit pension schemes.	Funding position can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities.	RBSH Group manages pension risk from a sponsor perspective using a framework that encompasses risk reporting and monitoring, stress testing, modeling and an associated governance structure that helps ensure RBSH Group is able to fulfill its obligation to support the defined benefit pension schemes to which it has exposure.

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

Capital management

Capital management

Introduction

RBSH Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements, and RBSH Group operates within an agreed risk appetite.

The appropriate level of capital is determined based on the dual aims of: (i) meeting minimum regulatory capital requirements; and (ii) ensuring RBSH Group maintains sufficient capital to uphold investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

2012 achievements

RBSH Group's Tier 1 ratio of 13.9% is higher than the end of 2011 in the face of challenging economic headwinds and continuing costs of de-risking. This has been achieved through a continued focus on reshaping the RBSH Group's use of capital.

RBSH Group has developed its stress testing capability to identify the impact of a wider set of potential scenarios. The stress outcomes show that the derisking in RBSH Group has been effective in reducing the impacts of stress scenarios and at the same time the capital ratios have been improving, resulting in increased capital buffers. The changes to the risk profiles as a result of de-risking include the Transfers to RBS plc, in particular the Dutch Scheme, run-down of Non-Core, reduction in concentrations, and revising the strategic footprint of the Markets division.

The capital allocation approaches used in RBSH Group will be developed to become increasingly risk sensitive and align risk management and resource allocation more fully.

Governance and approach

RBSH Group Asset and Liability Management Committee (ALCO) is responsible for ensuring RBSH Group maintains adequate capital at all times. The RBSG Group Capital and Stress Testing Committee (CAST) is a cross-functional body driving and directing integrated risk capital activities including determination of the amount of capital RBSH Group should hold, how and where capital is allocated and planning for actions that would ensure that an adequate capital position would be maintained in a stressed environment. These activities have linkages to capital planning, risk appetite and regulatory change. CAST reports through ALCO and comprises senior representatives from RBSH Group Risk, RBSH Group Finance and RBSH Group Treasury.

Determining appropriate capital

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

RBSH Group's own determination of how much capital is sufficient is derived from the desired credit rating level, risk appetite and reflects the current and emerging regulatory requirements of RBSH Group.

It is evaluated through the application of both internally and externally defined stress tests that identify potential changes in capital ratios to a range of scenarios.

RBSH Group identifies the management and recovery actions that could be applied to stress environments. These form an important part of the capital management approach and the contingency planning arrangements, complementing the established buffers.

Monitoring and maintenance
Based on these determinations, which are continually reassessed, RBSH Group aims to maintain capital adequacy.

RBSH Group operates a rigorous capital planning process aimed at ensuring the capital position is controlled within the agreed parameters. This incorporates regular re-forecasts of the capital position of RBSH Group. In the event that the projected position deteriorates beyond acceptable levels, RBSH Group would revise business plans accordingly.

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

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

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

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

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

Capital management continued

Capital ratios and risk-weighted assets

RBSH Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements. RBSH Group's RWAs and capital ratios are set out below.

	2012	2011(1)	2010(1)
Capital ratios	%	%	%
Core Tier 1	11.7	8.6	8.8
Tier 1	13.9	12.0	11.0
Total	19.8	17.5	15.8

	2012	2011(1)	2010
Risk-weighted assets	€m	€m	€m
Credit risk	26,336	50,197	64,200
Market risk (2)	3,389	5,353	1,272
Operational risk	2,994	3,163	4,324
Settlement risk	20	-	-
	32,739	58,713	69,796

Notes:

(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

(2) Market risk RWAs in 2011 were largely impacted by the new CRD III rules.

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

The risk-weighted assets for 2012 reduced due to changes in the structure of the balance sheet following the Transfers to RBS plc, in particular the Dutch Scheme and reductions in Non-Core. Capital ratios are higher than at 31 December 2011, reflecting the reduction in risk-weighted assets as discussed above. This is partially offset by the impact on regulatory capital of a revised interpretation of the tax treatment of certain adjustments.

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

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

Capital management continued

Capital resources and flow statement

RBSH Group's regulatory capital resources were as follow:

Composition of regulatory capital	2012 €m	2011(1) €m	2010(1) €m
Tier 1			
Controlling interests	1,799	3,395	4,958
Non-controlling interests	-	21	24
Adjustment for:			
– Goodwill and other intangible assets	(4)	(10)	(25)
– Unrealised losses on available-for-sale debt securities	2,492	3,066	2,530
– Unrealised gains on available-for-sale equities	(19)	(148)	(112)
– Other regulatory adjustments	(442)	(1,298)	(1,265)
Core Tier 1	3,826	5,026	6,110
Trust preferred securities	2,470	2,511	2,421
Less deductions from Tier 1 capital	(1,757)	(475)	(876)
Total Tier 1	4,539	7,062	7,655
Tier 2			
Unrealised gains on available-for-sale equities	19	148	112
Subordinated debt	3,218	3,699	4,105
Less deductions from Tier 2 capital	(1,303)	(639)	(876)
Total Tier 2	1,934	3,208	3,341
Total regulatory capital	6,473	10,270	10,996

The table below analyses the movement in Core Tier 1 capital during the year.

Movement in Core Tier 1 capital	2012 €m
As at 1 January 2012 (1)	5,026
Regulatory adjustment: fair value changes in own credit spreads	839
Foreign currency reserves	(184)
Loss of non-controlling interest and reduction in goodwill	6
Result current year	(999)
Transfer resulting from Dutch Scheme	(868)
Other	6
As at 31 December 2012	3,826

Note:

(1) Restated to reflect the investment in Saudi Hollandi Bank, Riyadh, refer to page 121- Accounting Policy 2 for details.

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Capital management continued

Looking forward

Basel III

The rules issued by the Basel Committee on Banking Supervision (BCBS), commonly referred to as Basel III, are a comprehensive set of reforms designed to strengthen the regulation, supervision, risk and liquidity management of the banking sector.

In December 2010, the BCBS issued the final text of the Basel III rules, providing details of the global standards agreed by the Group of Governors and Heads of Supervision, the oversight body of the BCBS and endorsed by the G20 leaders at their November 2010 Seoul summit.

The new capital requirements regulation and capital requirements directive that implement Basel III proposals within the European Union (EU) (collectively known as CRD IV) are in two parts, Capital Requirements Directive (CRD) and the Capital Requirements Regulation. Further technical detail will be provided by the European Banking Authority through its Implementing Technical Standards and Regulatory Technical Standards.

The CRD IV has not yet been finalised and consequently the Basel III implementation date of 1 January 2013 has been missed. While it is anticipated that agreement of the CRD IV will be achieved during 2013, the implementation date remains uncertain.

The changes in the definition of regulatory capital under CRD IV and the capital ratios will be subject to transitional rules:

- The increase in the minimum capital ratios and the new buffer requirements will be phased in over the five years from implementation of the CRD IV;

- The application of the regulatory deductions and adjustments at the level of common equity, including the new deduction for deferred tax assets, will also be phased in over the five years from implementation; the current adjustment for unrealised gains and losses on available-for-sale securities will be phased out; and

- Subordinated debt instruments which do not meet the new eligibility criteria will be will be grandfathered on a reducing basis over ten years.

Other regulatory capital changes

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

The overall impacts of the regulatory changes are fully factored into the capital plans of RBSH Group and its businesses.

Liquidity, funding and related risks

Liquidity, funding and related risks

Introduction

Liquidity risk is the risk that RBSH Group is unable to meet its obligations, including financing maturities as they fall due. Liquidity risk measurement is highly dependent on firm specific characteristics such as the maturity profile and mix of RBSH Group's funding base, as well as the quality and liquidity value of its liquidity portfolio as well as broader market factors, such as wholesale funding market conditions, and depositor and investor behaviour. Managing liquidity risk effectively is a key component of RBSH Group's risk reduction strategy.

A comprehensive well established approach to liquidity risk stress testing is one of the cornerstones of RBSH Group's liquidity risk management approach.

2012 achievements and looking forward

2012 represented an unsettled year in the capital markets with stabilisation only appearing from late summer onwards in response to various co-ordinated central bank actions and announcements. RBSH Group regularly undertakes stress tests of its liquidity risk position as further described. These stress tests simulate challenging events by analysing the potential impacts of rating agency downgrades and the possible liquidity impacts of extensive further dislocation within the eurozone including the possibility of an exit by certain members. These results are reflected in the amounts held in liquidity reserve over the year and the results are syndicated with senior management and were shared with the DNB. Recent events in 2012 where RBSH Group has experienced well publicised downgrades and other stressors indicate that our liquidity stress testing regime is robust and comprehensive.

Overall RBSH Group has benefited by the continued focus on de-risking and downsizing of its balance sheet. A smaller balance sheet requires less overall funding and a less risky balance sheet that presents smaller contingent stress requirement. With a smaller balance sheet and stable liquidity buffer RBSH Group has been able to both actively reduce short term wholesale funding and issue far lower amounts of new wholesale term funding. Looking forward, RBSH Group is expected to have a lower wholesale funding requirement going forward.

Liquidity risk

Policy, framework and governance

Governance

RBSH Group has in place a robust and comprehensive set of policies and procedures for assessing, measuring and managing the liquidity risk within RBSH Group. This ensures that RBSH Group always maintains sufficient eligible and appropriate financial resources to meet its forward looking financial commitments as they fall due.

RBSH Group is subject to the De Nederlandsche Bank's (DNB) supervisory regime for liquidity and each member of RBSH Group also complies with their local regulatory framework for the assessment and management of liquidity risk as well as meeting internal standards.

Overall RBSH Group's liquidity risk appetite is set by the Managing Board. RBSH Group's liquidity reserve is managed by RBSH Group Treasury.

Local liquidity reserves are the responsibility of Divisional treasurers who report to RBSH Group Treasurer functionally.

In meeting current DNB standards for managing liquidity risk RBSH Group undertakes an Individual Liquidity Adequacy Assessment (ILAA) which takes into account RBSH Group analysis of liquidity risk and the results of stress testing. Broadly speaking the ILAA demonstrates that RBSH Group has analysed each of the sources of liquidity risk that could impact it and taken actions to monitor and mitigate those risks.

RBSH Group has identified 10 specific liquidity risk factors which range from the risk associated with both behavioural and contractual customer deposit outflows through to firm specific reputational factors that could impact RBSH Group's liquidity position from time to time. The DNB's review of the ILAA ultimately results in the agreement between RBSH Group and the DNB which sets the parameters for the DNB's oversight of RBSH Group's liquidity risk.

In addition, RBSH Group follows the broader market developments in respect of the ongoing evolution of industry and regulatory liquidity risk policies that are currently being debated at an international level and adjusts its policies and processes where appropriate.

RBSH Group actively monitors ongoing regulatory developments in the international arena. Whilst most individual country regulators have implemented or refined specific country liquidity regulations, much work continues at an international level to agree common standards.

The majority of this work is conducted under the auspices of the Basel Committee on Bank Supervision and includes discussion on important measures such as the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). RBSH Group will always look to proactively adopt such measures into its reporting capabilities provided that there is an alignment and agreement between domestic and international regulators on these issues and specific country regulatory rules are updated to reflect these agreements.

Liquidity measurement and monitoring

Liquidity risk is measured and assessed on a daily basis at RBSH Group level. RBSH Group Treasury uses a set of internal metrics and analysis including stress testing, limit setting and ongoing monitoring. Specific RBSH Group subsidiaries or legal entities may also need to set similar liquidity risk appetites, hold eligible liquidity buffers and otherwise comply with specific local liquidity regulatory requirements.

RBSH Group also uses appropriate transfer pricing of liquidity costs to help induce appropriate pricing behaviour and decision making. RBSG Group's internal transfer pricing policy is used to support management of the balance sheet mix and composition of contingent and actual liabilities. This helps to ensure that liquidity risk is reflected in product pricing and divisional business performance measurement thereby ensuring that divisions are being correctly incentivised to source the most appropriate mix of funding.

Stress and scenario testing is used to inform a broader understanding of liquidity risk as well as to model specific liquidity risks events, for example the secession of a country from the euro.

Liquidity funding and related risks: Liquidity risk: Policy, framework and governance continued
RBSH Group actively monitors a range of market and firm-specific indicators on an ongoing basis which are designed to act as early warning indicators that liquidity stresses may be emerging. Some of these indicators will be actual performance of the business against pre-agreed limits, for example customer deposit outflows. Others will be based around general or specific market movements such as movements in RBSH Group's credit default swap spreads.

RBSH Group's liquidity risk framework is subject to internal oversight, challenge and governance both at Managing Board level and via internal control functions such as Internal Audit. RBSH Group is also subject to regulatory review and challenge from the DNB.

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

Simulated liquidity stress testing is regularly performed for each business as well as the major operating subsidiaries. Stress tests are designed to look at the impact of a variety of firm-specific and market-related scenarios on the adequacy of RBSH Group's liquidity resources at various points in time. Stress tests can therefore be run on an ad hoc basis in response to the emergence of one of these risks.

Scenarios include assumptions about significant changes in key funding sources, external credit ratings, contingent uses of funding, and political and economic conditions or events in particular countries. Stress scenarios are applied to both on-balance sheet instruments and off-balance sheet activities, to provide a comprehensive view of potential cash flows.

In determining the adequacy of RBSH Group's liquidity resources RBSH Group focuses on the stressed outflows it could be anticipated to experience as a result of any stress scenario occurring. These outflows are measured as occurring over certain time periods which extend from any given day out to two weeks to as long as three months. RBSH Group is expected to be able to withstand these stressed outflows through its own resources over these time horizons without having to revert to extraordinary central bank or governmental assistance.

RBSH Group's actual experiences from the 2008 and 2009 period have factored heavily into the liquidity analysis in the past although more recent market conditions and events provide more up to date data for scenario modelling. Stress tests are augmented from time to time to reflect firm specific or emerging market risks that could have a material impact on RBSH Group's liquidity position.

The results of stress testing are an active part of management and strategy in balance sheet management and inform allocation, target and limit discussions. In short limits in the business-as-usual environment are bounded by capacity to satisfy the Group's liquidity needs in the stress environments.

Contingency planning
RBSH Group has a Contingency Funding Plan (CFP), which is updated as the balance sheet evolves and forms the basis of analysis and actions to remediate adverse circumstances as and if they arise. The CFP is linked to stress test results and forms the foundation for liquidity risk limits. The CFP provides a detailed description of the availability, size and timing of all sources of contingent liquidity available to RBSH Group in a stress event. These are ranked in order of economic impact and effectiveness to meet the anticipated stress requirement. The CFP includes documented processes for actions that may be required to meet the outflows. Roles and responsibilities for the effective

implementation of the CFP are also documented. RBSH Group's CFP is fully integrated with the CFP of RBSG Group.

Liquidity reserves

RBSH Group analyses its liquidity reserve including its locally managed liquidity pools into primary and secondary liquidity groups. The primary liquidity group generally reflects core eligible liquid assets, such as cash and balances at central banks, treasury bills and other high quality government and agency bonds, and other local primary qualifying liquid assets for each of the significant operating subsidiaries that maintain a local liquidity pool. Secondary liquidity assets represent other qualifying liquid assets that are eligible for local central bank liquidity facilities but do not meet the core local regulatory definition.

RBSH Group in consultation with the DNB and subject to the applicable limits can change the composition of its liquidity reserve. The change in composition may relate to market specific factors, changes in internal liquidity risk appetite or regulatory guidance.

Regulatory oversight

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

Funding risk

Funding sources

As part of the reduction in RBSH Group's balance sheet, RBSH Group's strategy has been to limit access to external funding sources across the globe, including short-term money markets, repurchase agreement markets and term debt investors through its secured and unsecured funding programmes. Funding is now concentrated with RBSG Group, who given their active role in the money markets, along with access to global capital flows through its international client base provide funding to ensure RBSH Group's funding is well diversified by currency, geography, maturity and type.

Central bank funding

RBSH Group may access various funding facilities offered by central banks from time to time. The use of such facilities can be both part of a wider strategic objective to support initiatives to help stimulate economic growth or as part of RBSH Group's broader liquidity management and funding strategy. Overall usage and repayment of available central bank facilities will fit within RBSH Group's overall liquidity risk appetite and concentration limits contained therein so as not to create outsized maturity exposures.

During 2012, RBSH Group drew down €3.5 billion of funding under the European Central Bank's Long Term Refinancing Operation.

Liquidity funding and related risks: Funding risk continued

Balance sheet composition

RBSH Group's balance sheet composition is a function of the product offerings and markets served by its Core divisions. The structural composition of the balance sheet is augmented as needed through active management of both asset and liability portfolios. The objective of these activities is to optimise liquidity transformation in normal business environments, in line with RBSH Group's strategy, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

Encumbrance

RBSH Group encumbers certain assets as further described herein which serve as collateral to support certain funding initiatives. The principal form of encumbrance is securities repurchase agreements.

RBSH Group categorises its assets into two broad groups; assets that are:

- already encumbered and are used to support funding currently in place via securities repurchase agreement.
- not currently encumbered but can for instance be used to access funding from market counterparties or central bank facilities as part of the Group's contingency funding.

RBSH Group reviews all assets against the criteria of being able to finance them in a secured form (encumbrance) but certain asset types lend themselves more readily to encumbrance. The typical characteristics that support encumbrance are an ability to pledge those assets to another counterparty or entity through operation of law without necessarily requiring prior notification, homogeneity, predictable and measurable cash flows and a consistent and uniform underwriting and collection process. Retail assets including residential mortgages, credit card receivables and personal loans display many of these features.

Liquidity and funding risk: analyses

Funding sources

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

	2012		2011		2010	
	€m	%	€m	%	€m	%
Deposits by banks	21,841	64.4	29,988	32.1	27,178	19.8
Debt securities in issue						
- Commercial paper	8	0.0	1,563	1.7	5,843	4.3
- Certificates of deposit	108	0.3	2,326	2.5	2,882	2.1
- Medium term notes and other bonds (including securitisations)	2,486	7.4	13,825	14.8	44,686	32.5
	2,602	7.7	17,714	19.0	53,411	38.9
Subordinated liabilities	6,851	20.2	6,859	7.3	6,894	5.0
Total wholesale funding	31,294	92.3	54,561	58.4	87,483	63.7
Customer deposits	2,620	7.7	38,842	41.6	49,886	36.3

Total funding	33,914	100.0	93,403	100.0	137,369	100.0

Notes issued

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

	Debt securities in issue					
	Commercial paper and certificates of deposit	MTNs (including securitisations)	Total	Subordinated liabilities	Total	
2012	€m	€m	€m	€m	€m	%
Less than one year	116	445	561	11	572	6.0
1-3 years	-	605	605	2,674	3,279	34.7
3-5 years	-	545	545	-	545	5.8
More than 5 years	-	891	891	4,166	5,057	53.5
	116	2,486	2,602	6,851	9,453	100.0
2011						
Less than one year	3,887	1,711	5,598	61	5,659	23.0
1-3 years	-	4,353	4,353	56	4,409	18.0
3-5 years	2	4,233	4,235	2,672	6,907	28.1
More than 5 years	-	3,528	3,528	4,070	7,598	30.9
	3,889	13,825	17,714	6,859	24,573	100.0

Liquidity funding and related risks: Liquidity and funding risk: analyses: Funding sources continued

	Debt securities in issue					
	Commercial paper and certificates of deposit	MTNs (including securitisations)	Total	Subordinated liabilities	Total	
2010	€m	€m	€m	€m	€m	%
Less than one year	8,721	5,741	14,462	4	14,466	24.0
1-3 years	2	10,560	10,562	-	10,562	17.5
3-5 years	2	11,141	11,143	2,592	13,375	22.8
More than 5 years	-	17,244	17,244	4,298	21,542	35.7
	8,725	44,686	53,411	6,894	60,305	100.0

Key points
- The reduction of commercial paper and certificates of deposit outstanding reflects positions maturing in Markets and Group Treasury.
- The reduction of medium term notes is related to maturities and the transfer of securities to RBS plc as part of the Dutch Scheme in September 2012.

Liquidity portfolio
RBSH Group is subject to the DNB's supervisory regime for liquidity and each member of RBSH Group also complies with their local supervisory framework for the assessment and management of liquidity risk as well as meeting internal standards. RBSH Group's liquidity portfolio is managed by RBSH Group Treasury. Local liquidity portfolios are the responsibility of local treasurers who report to the RBSH Group Treasurer functionally. RBSH Group analyses its liquid assets including its locally managed liquidity pools into primary and secondary liquidity groups.

The primary liquidity group generally reflects core eligible liquid assets (meeting the European Central Bank's (ECB) definition), such as cash and balances at central banks, treasury bills and other high quality government and agency bonds, and other local primary qualifying liquid assets for each of the significant operating subsidiaries that maintains a local liquidity pool. Secondary liquidity assets represent other qualifying liquid assets that are eligible for local central bank liquidity facilities but do not meet the local regulator's definition of core eligible liquid assets.

The table below shows the composition of RBSH Group's liquidity portfolio (at estimated liquidity value). A significant proportion of the assets within the liquidity portfolio are encumbered as at the balance sheet date in line with RBSH Group's strategy.

	2012			
	Average	Period end	2011	2010
	€m	€m	€m	€m
Cash and cash equivalents	12,871	5,345	14,346	8,323
Central and local government bonds				
- AAA rated governments and US agencies	864	672	-	4,949

- AA- to AA+ rated governments	1,562	530	-	1,554
- governments rated below AA	729	253	1,142	1,193
- local government	2,731	1,201	5,143	6,576
	5,886	2,656	6,285	14,272
Unencumbered collateral				
- AAA rated	1,510	249	3,907	7,759
- below AAA rated and other high quality assets	861	-	3,536	3,680
	2,371	249	7,443	11,439
Total liquidity portfolio	21,128	8,250	28,074	34,034

Key points

- RBSH Group's central liquidity reserves reduced by €19.8 billion to €8.2 billion as at year end. This was largely due to reduced liquidity requirements following the transfer of assets and liabilities to RBS plc as part of the Dutch Scheme in September 2012.
- The reduction in central and local government bonds was driven mainly by a reduction in eurozone government bonds. AAA rated governments and US agencies and AA- to AA+ rated governments bonds in December 2011 were subject to repurchase transactions with RBS plc. The US Government was downgraded from AAA to AA+ by S&P on 5 August 2011 and its debt securities carry a split credit rating, these securities are included in AA- to AA+ rated governments.
- The reduction in unencumbered collateral was driven mainly by a reduction in Spanish institutional securities and accessing some funding through the European Central Banks long-term refinancing operation facility.
- The composition of the liquidity portfolio will vary over time based on changing regulatory requirements and internal evaluation of liquidity needs under stress. There are no restrictions over the disposition of the portfolio by RBSG Group management subject to meeting liquidity requirements imposed by the DNB.

Liquidity funding and related risk: Liquidity and funding risk: analyses continued

Securities repurchase agreements and lending transactions

RBSH Group enters into securities repurchase agreements and securities lending transactions under which it transfers securities in accordance with normal market practice. Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

Securities sold under repurchase transactions are not derecognised if RBSH Group retains substantially all the risks and rewards of ownership. The fair value (and carrying value) of securities transferred under such repurchase transactions included within debt securities on the balance sheet are set out below. All of these securities could be sold or repledged by the holder.

	2012 €m	2011 €m	2010 €m
Deposits by banks - repurchase agreements and stock lending	12,624	16,532	4,807
Customer accounts - repurchase agreements and stock lending	18	759	5,019

Maturity analysis

The contractual maturity of on-balance sheet assets and liabilities highlights the maturity transformation which underpins the role of banks to lend long-term, but to fund themselves predominantly by short-term liabilities such as customer deposits. This is achieved through the funding profile of RBSH Group principally with RBSG Group. In practice, the behavioural profiles of many assets and liabilities exhibit greater stability and longer maturity than the contractual maturity.

The following table shows the contractual residual maturity of financial assets and liabilities excluding financial assets and liabilities held for trading and related hedging derivatives.

	Other than Held for Trading (HFT)							
	Less than 1 month	1 - 3 months	3 - 6 months	6 months -1 year	1 - 3 years	3 - 5 years	More than 5 years	Total
2012	€m	€m	€m	€m	€m	€m	€m	€m
Cash and balances at central banks	2,294	-	-	-	-	-	-	2,294
Loans and advances to banks (excluding reverse repos)	7,777	492	356	69	582	264	4,026	13,566
Bank reverse repos	62	-	-	-	-	-	-	62
Loans and advances to customers (excluding reverse)	20	507	632	833	678	1,115	2,142	5,927
Customer reverse repos	-	-	-	-	-	-	-	-
Debt securities	304	88	169	243	2,768	5,020	13,218	21,810
Equity shares	-	-	-	-	-	-	98	98
Settlement balances	29	-	-	-	-	1	1	31

Total assets	10,486	1,087	1,157	1,145	4,028	6,400	19,485	43,788
Deposits by banks (excluding repos)	3,850	5,062	7,271	7	3,810	67	469	20,536
Bank repos	12,613	-	-	-	-	-	-	12,613
Customer accounts (excluding repos)	1,093	158	170	51	270	142	69	1,953
Customer repos	3	-	-	-	-	-	-	3
Debt securities in issue	80	61	170	207	574	545	892	2,529
Settlement balances and short portions	71	-	-	-	2	-	-	73
Subordinated liabilities	-	7	3	2	2,674	-	4,165	6,851
Total liabilities	17,710	5,288	7,614	267	7,330	754	5,595	44,558

Business review Risk and balance sheet management continued

Liquidity funding and related risks: Liquidity and funding risk: analyses: Maturity analysis continued

	Other than Held for Trading (HFT)							
2011	Less than 1 month €m	1 - 3 months €m	3 - 6 months €m	6 months -1 year €m	1 - 3 years €m	3 - 5 years €m	More than 5 years €m	Total €m
Cash and balances at central banks	12,605	4	-	-	-	-	-	12,609
Loans and advances to banks (excluding reverse repos)	12,288	60	93	375	401	1,208	1,362	15,787
Bank reverse repos	8,329	771	-	-	-	-	-	9,100
Loans and advances to customers (excluding reverse)	6,215	3,560	2,473	3,332	4,852	3,423	4,474	28,329
Customer reverse repos	206	77	-	-	-	-	-	283
Debt securities	1,619	1,637	1,144	1,265	6,089	4,033	18,635	34,422
Equity shares	-	-	-	-	-	-	535	535
Settlement balances	2,594	1	10	-	-	-	3	2,608
Total assets	43,856	6,110	3,720	4,972	11,342	8,664	25,009	103,673
Deposits by banks (excluding repos)	13,740	12,299	584	461	665	789	202	28,740
Bank repos	6,685	9,847	-	-	-	-	-	16,532
Customer accounts (excluding repos)	33,688	1,306	1,309	329	597	214	382	37,825
Customer repos	759	-	-	-	-	-	-	759
Debt securities in issue	2,061	1,590	831	1,117	4,353	4,169	3,528	17,649
Settlement balances and short positions	2,844	1	-	-	-	-	-	2,845
Subordinated liabilities	-	26	16	19	56	2,496	4,245	6,858
Total liabilities	59,777	25,069	2,740	1,926	5,671	7,668	8,357	111,208

	Other than Held for Trading (HFT)							
2010	Less than 1 month €m	1 - 3 months €m	3 - 6 months €m	6 months -1 year €m	1 - 3 years €m	3 - 5 years €m	More than 5 years €m	Total €m
Cash and balances at central banks	4,787	3	-	3,522	-	-	11	8,323
Loans and advances to banks (excluding reverse repos)	18,831	1,008	708	374	723	165	513	22,322
Bank reverse repos	3,572	671	-	29	-	-	-	4,272
Loans and advances to customers (excluding reverse)	9,580	4,102	2,741	2,944	9,464	5,437	6,055	40,323
Customer reverse repos	3,888	-	-	-	-	-	-	3,888
Debt securities	5,186	1,429	456	2,243	7,864	5,140	21,131	43,449
Equity shares	-	-	-	-	-	-	909	909
Settlement balances	3,458	67	28	-	20	-	-	3,573

Total assets	49,302	7,280	3,933	9,112	18,071	10,742	28,619	127,059
Deposits by banks (excluding repos)	19,829	2,738	1,140	552	921	684	1,222	27,086
Bank repos	4,807	-	-	-	-	-	-	4,807
Customer accounts (excluding repos)	40,613	2,482	487	458	213	923	2,590	47,766
Customer repos	4,480	417	-	-	-	4	26	4,927
Debt securities in issue	5,392	4,183	2,225	2,662	10,562	11,194	17,188	53,406
Settlement balances and short positions	2,810	39	47	-	-	-	-	2,896
Subordinated liabilities	4	-	-	-	-	2,593	4,298	6,895
Total liabilities	77,935	9,859	3,899	3,672	11,696	15,398	25,324	147,783

Liquidity, funding and related risks continued

Non-traded interest rate risk

Non-traded interest rate risk impacts earnings arising from RBSH Group's banking activities. This excludes positions in financial instruments which are classified as held for trading, or hedging items.

RBSH Group provides a range of financial products to meet a variety of customer requirements. These products differ with regard to repricing frequency, tenor, indexation, prepayments, optionality and other features. When aggregated, they form portfolios of assets and liabilities with varying degrees of sensitivity to changes in market rates.

Mismatches in these sensitivities give rise to net interest income volatility as interest rates rise and fall. For example, a bank with a floating rate loan portfolio and largely fixed rate deposits will see its net interest income rise as interest rates rise and fall as rates decline.

RBSH Group policy is to manage interest rate sensitivity in banking book portfolios within defined risk limits. Interest rate risk is transferred from the banking divisions to RBSH Group Treasury. Aggregate positions are then hedged externally using cash and derivative instruments, primarily interest rate swaps, to manage exposures within RBSH Group Asset and Liability Management Committee (ALCO) approved limits. RBSH Group is required to manage interest rate risk in the banking book (IRRBB) through transactions with RBS Plc to the greatest extent possible.

RBSH Group assesses IRRBB using a set of standards to define, measure and report the risk.

Key measures used to evaluate IRRBB are subjected to approval granted by the ALCO. Limits on IRRBB are set according to the Non-Trading Interest Rate and Foreign Currency Risk Policy Statement and are subject to RBSH Group ALCO approval. IRRBB is measured using a version of the same Value at Risk (VaR) methodology that is used by RBSG Group.

Residual risk positions are routinely reported to ALCO, the Managing and Supervisory board and the RCC. VaR metrics are based on interest rate repricing gap reports as at the reporting date. These incorporate customer products and associated funding and hedging transactions as well as non-financial assets and liabilities such as property, equipment, capital and reserves. Behavioural assumptions are applied as appropriate.

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

	Average	Period end	Maximum	Minimum
	€m	€m	€m	€m
2012	6.0	5.2	9.6	4.4
2011	10.0	8.3	15.2	7.4
2010	30.1	16.2	69.9	16.2

Key points

- VaR continued to reduce in 2012 following the Transfers to RBS plc in the last quarter of 2011 and 2012.

Liquidity, funding and related risks continued

Structural foreign currency exposures

RBSH 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 table below sets out RBSH Group structural foreign currency exposures.

2012	Net investments in foreign operations (1) €m	Net investment hedges €m	Structural foreign currency exposures €m
US dollar	1,259	(960)	299
Pound sterling	(397)	75	(322)
Other non-euro	2,558	(2,034)	524
	3,420	(2,919)	501
2011			
US dollar	1,334	(1,129)	205
Pound sterling	721	(715)	6
Other non-euro	3,749	(2,310)	1,439
	5,804	(4,154)	1,650
2010			
US dollar	1,271	(730)	541
Pound sterling	1,358	(1,238)	120
Other non-euro	3,779	(2,298)	1,481
	6,408	(4,266)	2,142

Note:

(1) Includes minority participations.

Key points

- RBSH Group’s structural foreign currency exposure at 31 December 2012 was €0.5 billion, a decrease of €1.1 billion primarily as a result of the Transfers to RBS plc in the last quarter of 2011 and 2012.

Sensitivity of equity to exchange rates

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

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

2012		2011		2010	
Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%	Euro appreciates 10%	Euro depreciates 10%
€m	€m	€m	€m	€m	€m
(45)	55	(162)	165	(367)	435

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Credit risk

Credit risk

Introduction

Risk management is conducted on an overall basis within RBSG Group. Therefore the discussion on pages 51 to 58 refer principally to policies and procedures in RBSG Group that also apply to RBSH Group. Credit risk is the risk of financial loss due to the failure of a customer or counterparty to meet its obligation to settle outstanding amounts. The credit risk that RBSH Group faces arises mainly from wholesale lending, provision of contingent obligations (such as letters of credit and guarantees) and counterparty credit risk arising from derivative contracts and securities financing transactions entered into with customers. Other material risks covered by RBSG Group's credit risk management framework are:

- Concentration risk - the risk of an outsized loss due to the concentration of credit risk to a specific asset class or product, industry sector, customer or counterparty, or country.
- Settlement risk - the intra-day risk that arises when RBSH Group releases funds prior to confirmed receipt of value from a third party.
- Issuer risk - the risk of loss on a tradable instrument (e.g. bond, equity or synthetic instrument such as a credit default swap) due to default by the issuer.
- Wrong way risk - the risk of loss that arises when the risk factors driving the exposure to a counterparty or customer are positively correlated with the probability of default for that counterparty.
- Credit mitigation risk - the risk that credit risk mitigation is not enforceable or that the value of such mitigation decreases, thus leading to unanticipated losses.

Top and emerging credit risks

The quantum and nature of credit risk assumed across RBSH Group's different businesses vary considerably, while the overall credit risk outcome usually exhibits a high degree of correlation with the macroeconomic environment. RBSH Group therefore remains sensitive to the economic conditions within the geographies in which it operates in, in particular the eurozone, Asia Pacific, US and UK.

The following credit risks continue to be the focus of management attention.

Eurozone troubles

The ongoing impact of the troubles in the eurozone continued to be felt most significantly in the banking sector, where widening credit spreads and regulatory demand for increases in Tier 1 capital and liquidity exacerbated the risk management challenges already posed by the sector's continued weakness, as provisions and write-downs remain elevated.

A material percentage of global banking activity in risk mitigation now passes through the balance sheets of the top global players, increasing the systemic risks to the banking sector. RBSH Group's exposures to these banks continue to be closely managed. In particular, RBSH Group has intensified its management of settlement risk through ongoing review of the level of risk and the operational controls in place to manage it, together with proactive actions to reduce limits. The weaker banks in the eurozone also remained subject to heightened scrutiny and RBSG Group's risk appetite for these banks was adjusted throughout 2012.

RBSG Group has continued to focus on operational preparations for possible sovereign defaults and/or eurozone exits.

RBSG Group has also considered initiatives to determine and reduce redenomination risk. Further actions to mitigate risks and strengthen control in the eurozone typically included taking guarantees or insurance, updating collateral agreements, and tightening certain credit pre-approval processes. RBSH Group has a material exposure to Spanish AFS debt securities issued by banks and other financial institutions of €5.8 billion at 31 December, predominately comprised of covered bonds backed by mortgages. Whilst the exposure was reduced by €1.5 billion during 2012, largely as a result of sales, the portfolio continues to be subject to heightened scrutiny, including undertaking stress analysis. Further details on RBSH Group's approach to managing country risk and the risks faced within the eurozone can be found on pages 76 to 84.

Retailers

Given the cyclical nature of the retail corporate sector and its sensitivity to stressed economic conditions, RBSG Group has continued to apply heightened scrutiny to this portfolio. Loss experience on the RBSH Group's retail portfolio remained low during 2012, as a result of active management. The portfolio is generally well diversified by geography and by counterparty.

Renegotiations

Loan modifications take place in a variety of circumstances including but not limited to a customer's current or potential credit deterioration. Where the contractual payment terms of a loan have been changed because of the customer's financial difficulties, it is classified as 'renegotiated' in the wholesale portfolio. RBSH uses renegotiations as a management tool to support viable customers through difficult financial periods during business cycles. Used wisely, they can reduce the incidence of bankruptcies for otherwise successful enterprises. On a broader scale they can also help reduce the impact of 'fire sale' pricing on real economic assets. However, they must be used selectively and require additional management vigilance throughout the loan life cycle. RBSH Group has continued to take steps to improve its management and reporting of such loans within its corporate businesses.

Objectives, organisation and governance

The existence of a strong credit risk management function is vital to support the ongoing profitability of RBSG Group. The potential for loss through economic cycles is mitigated through the embedding of a robust credit risk culture within the business units and through a focus on the importance of sustainable lending practices. The role of the credit risk management function is to own the credit approval, concentration and credit risk control frameworks and to act as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound lending environment within approved risk appetite. Responsibility for development of, and compliance with, RBSG Group-wide policies and credit risk frameworks and RBSG Group-wide assessment of provision adequacy resides with RBSG Group Credit Risk (GCR) function under the management of RBSG Group Chief Credit Officer. Execution of these policies and frameworks is the responsibility of the risk management functions, located within RBSG Group's business divisions.

Credit risk: Introduction continued

These divisional credit risk management functions work together with GCR to ensure that RBSG Group Board's expressed risk appetite is met, within a clearly defined and managed control environment. The credit risk function within RBSH Group is managed by the RBSG Group Chief Credit Officer, who also acts as RBSH Group Chief Credit officer and in that capacity reports to the RBSH Group Chief Risk Officer. RBSH Group's activities within credit risk include credit risk appetite setting, transaction and portfolio analysis, and ongoing credit risk monitoring and oversight.

Key trends in the credit risk profile of RBSH Group, performance against limits and emerging risks are set out in the Risk Report provided to the RCC, the Managing Board and the Supervisory Board.

Credit risk management framework

RBSG Group has established an appropriate and comprehensive framework for the management of credit risk that includes governance structures, risk appetite and concentration frameworks, policies, measurement and reporting tools and independent assurance.

In order to strengthen this framework and ensure consistent application across RBSG Group, during 2012 the GCR function launched a set of credit control standards that divisions must comply with, to supplement the existing policy suite. These standards address divisional governance and policy requirements and reflect a set of behavioural, organisational and management norms that drive a sound divisional control environment and embed a strong risk culture.

Risk appetite and concentration risk management

Risk appetite of RBSH Group has been set by RBSH Managing Board and is derived from the risk appetite as expressed by RBSG Group Board through the setting of specific quantitative risk appetite targets under stress. Of particular relevance in the management of credit risk for RBSH Group are the targets for capital adequacy. The credit risk framework has therefore been designed around the factors that influence RBSH Group's ability to meet these targets. These include the limiting of excess credit risk concentrations by product sector/asset class, industry sector, customer or counterparty (i.e. single name) and country any of which could generate higher volatility under stress and, if not adequately controlled, can undermine capital adequacy.

The frameworks are supported by a suite of RBSG Group-wide and divisional policies that set out the risk parameters within which business units may operate.

The management of concentration risk and associated limits are firmly embedded in the risk management processes of RBSG Group and form a pivotal part of the Risk function's engagement with the businesses on the appropriateness of risk appetite choices. The RBSG Group Executive Risk Forum (ERF), or delegated committee, has reviewed all material industry and product portfolios and agreed a risk appetite commensurate with the franchises represented in these reviews. In particular, limits have been reviewed and re-sized, to refine RBSG Group's risk appetite in areas where it faces significant balance sheet concentrations or franchise challenges. The need to control concentrations must at all times be balanced against the need to ensure sufficient capacity within credit limits to support customers of sound credit quality, in particular within retail and small business customer segments.

Through the overlay model, RBSH Group's concentration risks are captured in, and primarily governed by, the divisional and RBSG Group risk control frameworks. However concentration risks are actively monitored from an RBSH Group perspective through monthly reporting.

During 2012, the credit risk function expanded the scope of its credit risk appetite controls through the active management of non-financial risks in RBSG Group's lending decisions. The development of Environmental, Social and Ethical (ESE) risk policies for sectors considered to present a higher reputational risk (such as the defence, oil and gas sectors) provide a framework within which the RBSG Group can better manage its reputational risks. This ESE framework forms part of a wider initiative by the Group to improve reputational risk management and build trust with its stakeholders (for more information on reputational risk management, refer to page 98).

Product/ asset class

Retail - a formal framework establishes RBSG Group-level statements and thresholds that are cascaded through all retail franchises in RBSG Group and to granular business lines. These include measures that relate both to aggregate portfolios and to asset quality at origination, which are tracked frequently to ensure consistency with RBSG Group standards and appetite.

Wholesale - formal policies, specialised tools and expertise, tailored monitoring and reporting and, in certain cases, specific limits and thresholds are deployed to address certain lines of business across RBSG Group, where the nature of credit risk incurred could represent a concentration or a specific/heightened risk in some other form. Those portfolios identified as potentially representing a concentration or heightened risk are subject to formal governance, including periodic review, at either Group or divisional level, depending on materiality.

Sector concentration

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

The focus during 2012 was on embedding sector and sub-sector specific appetite within divisional policies and processes and on setting appropriate controls. This includes strengthening portfolio controls on key metrics and lending parameters and the ongoing development of sector specific lending policies.

Credit risk: Credit risk management framework continued

A sector concentration report, detailing aggregate lending exposures and recent trends is included in the Monthly Risk report discussed at the RCC and presented by the RBSH Group CRO to the Managing Board. This report is also distributed each month to the Supervisory Board, sector risk exposures are discussed by the Supervisory Board quarterly.

Single-name concentration

Within wholesale portfolios, much of the activity undertaken by the credit risk function is organised around the assessment, approval and management of the credit risk associated with a borrower or group of related borrowers. A formal single name concentration framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes specific and sometimes elevated approval requirements, additional reporting and monitoring, and the requirement to develop plans to address and reduce excess exposures over an appropriate timeframe.

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

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

A number of credit risk mitigation techniques are available to reduce single name concentrations. To be considered suitable, credit risk mitigants must be effective in terms of legal certainty and enforceability and maturity/expiry dates must be the same or later than the underlying obligations. Typical mitigant types include cash, bank/government guarantees, and CDS.

Since 2009, RBSG Group has been managing its corporate exposures to reduce concentrations and align its appetite for future business to RBSG Group’s broader strategies for its large corporate franchises. RBSG Group is continually reviewing its single name concentration framework to ensure that it remains appropriate for current economic conditions and in line with improvements in RBSG Group’s risk measurement models.

In 2012, RBSG Group implemented further refinements to the single name exposure management controls already in place, which brings them more closely in line with market best practice and which allows RBSG Group to differentiate more consistently between the different risk types.

Within RBSH Group, single name concentration limits are set in line with the RBSG Group’s framework. Limits are regularly reviewed and were further tightened during 2012 in order to align with the reduced credit portfolio and capital base following the Transfers to RBS plc that took place in 2012.

Country
For information on how RBSH Group manages credit risk by country, refer to the Country risk section on pages 76 to 84.

Controls and assurance
RBSG Group's credit control and assurance framework comprises three key components: credit policy, policy compliance assurance and independent assurance.

The foundation is RBSG Group Credit Policy Standard, which, as part of the Group Policy Framework (GPF), sets out the rules RBSG Group's businesses must follow to ensure that credit risks are identified and effectively managed through the credit lifecycle. During 2012, a major revision of RBSG Group's key credit policies was completed, ensuring that RBSG Group's control environment is appropriately aligned to the risk appetite that RBSG Group Board has approved, and provides a sound basis for RBSG Group's independent audit and assurance activities across the credit risk function.

The second component is a policy assurance activity that GCR undertakes to provide the RBSG Group Chief Credit Officer with evidence of the effectiveness of the controls in place across RBSG Group to manage credit risk. The results of these reviews are presented to RBSG Group Credit Risk Committee on a regular basis in support of the self-certification that GCR is obliged to complete under the GPF.

Finally, a strong independent assurance function is an important element of a sound control environment. During 2011, RBSG Group took the decision to strengthen its credit quality assurance (CQA) activities and moved all divisional CQA resources under the centralised management of GCR. The benefits of this action are already apparent in greater consistency of standards and cross-utilisation of resources, ensuring that subject matter experts bring their expertise to bear where relevant.

Reviews undertaken consistently address the four underlying risk pillars of: risk management, risk appetite, ratings and data integrity, and asset quality. Appropriate identification, escalation, remediation and related tracking of control breaches and improvements in operational processes are firmly embedded in the assurance process to ensure that divisions act upon review findings.

Credit risk continued

Credit risk measurement

RBSG Group uses credit risk models to support quantitative risk assessments within the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. Credit risk models used by RBSG Group may be divided into three categories, as follow:

Probability of default/customer credit grade

These models assess whether a customer will be able to repay its obligations over a one year period.

Wholesale models - As part of the credit assessment process, RBSG Group assigns each counterparty an internal credit grade based on its probability of default (PD). RBSG Group uses a number of credit grading models which consider risk characteristics relevant to the customer. Credit grading models utilise a combination of quantitative inputs, such as recent financial performance and qualitative inputs such as management performance or sector outlook. RBSG Group uses a credit grade in many of its risk management and measurement frameworks, including credit sanctioning and managing single-name concentration risk.

Retail models - Each customer account is scored using models based on the likelihood of default. Scorecards are statistically derived using customer data; customers are given a score that reflects their probability of default, and this score is used to support automated credit decision making.

Exposure at default models

Exposure at default (EAD) models estimate the level of use of a credit facility at the time of a borrower's default, recognising that customers make more use of their existing credit facilities as they approach default. For revolving and variable draw-down type products that are not fully drawn, the EAD is higher than the current utilisation. The estimate of exposure can be reduced with financial collateral provided by the obligor or a netting agreement.

Models that measure counterparty credit risk exposure are used for derivatives and other traded instruments, where the amount of credit risk exposure may depend on one or more underlying market variables, such as interest or foreign exchange rates. These models drive RBSG Group's internal credit risk management activities.

Loss given default models

Loss given default (LGD) models estimate the amount that cannot be recovered by the Group in the event of default. When estimating LGD, RBSG Group takes into account both borrower and facility characteristics, as well as any security held or credit risk mitigation, such as credit protection or insurance. The cost of collections and a time discount factor for the delay in cash recovery are also incorporated.

Changes to wholesale credit risk models

RBSG Group is updating its wholesale credit risk models, incorporating more recent data and reflecting new regulatory requirements applicable to wholesale internal ratings-based (IRB) modelling.

In 2012, RBSG Group implemented material updates to certain models, such as those used in the sovereign and financial institution asset classes; these updates affected the risk measures in RBSG Group's disclosures. Further updates, primarily of models used for the corporate asset class, are planned for 2013.

Updates to models have generally affected relatively low-risk segments of RBSG Group's portfolio. For example, the changes stemming from the introduction of updated probability of default models largely affected assets bearing the equivalent of investment-grade ratings. In anticipation of these changes, RBSG Group modified various risk frameworks, including its risk appetite framework and latent loss assessment. In addition, with the agreement of its regulators, RBSG Group adjusted upwards the risk-weighted assets (RWAs) of some portfolios prior to the introduction of the new models.

Credit risk mitigation

Approaches and methodologies

RBSG Group employs a number of structures and techniques to mitigate credit risk. Netting of debtor and creditor balances is undertaken in accordance with relevant regulatory and internal policies. Exposure on over-the-counter derivative and secured financing transactions is further mitigated by the exchange of financial collateral and the use of market standard documentation. Further mitigation may occur in a range of transactions, from retail mortgage lending to large wholesale financing. This can include: structuring a security interest in a physical or financial asset; use of credit derivatives, including credit default swaps, credit-linked debt instruments and securitisation structures; and use of guarantees and similar instruments (for example, credit insurance) from related and third parties. Such techniques are used in the management of credit portfolios, typically to mitigate credit concentrations in relation to an individual obligor, a borrower group or a collection of related borrowers.

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

- The suitability of qualifying credit risk mitigation types and any conditions or restrictions applicable to those mitigants;
- The means by which legal certainty is to be established, including required documentation, supportive independent legal opinions and all necessary steps required to establish legal rights;
- Acceptable methodologies for initial and any subsequent valuations of collateral and the frequency with which collateral is to be revalued and the use of collateral haircuts;
- Actions to be taken in the event that the value of mitigation falls below required levels;
- Management of the risk of correlation between changes in the credit risk of the customer and the value of credit risk mitigation;
- Management of concentration risks, for example, by setting thresholds and controls on the acceptability of credit risk mitigants and on lines of business that are characterised by a specific collateral type or structure; and
- Collateral management to ensure that credit risk mitigation remains legally effective and enforceable.

Credit risk: Credit risk mitigation continued

Secured portfolios

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

Corporate exposures

The type of collateral taken by RBSG Group's commercial and corporate businesses and the manner in which it is taken will vary according to the activity and assets of the customer.

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

- Real estate – RBSG Group takes collateral in the form of real estate which includes residential and commercial properties. The loan amount will typically exceed the market value of the collateral at origination date. The market value is defined as the estimated amount for which the asset could be sold in an arm's length transaction by a willing seller to a willing buyer.

- Receivables - when taking a charge over receivables, RBSG Group assesses their nature and quality and the borrower's management and collection processes. The value of the receivables offered as collateral will typically be adjusted to exclude receivables that are past their due dates.

The security charges may be floating or fixed, with the type of security likely to impact (i) the credit decision; and (ii) the potential loss upon default. In the case of a general charge such as a mortgage debenture, balance sheet information may be used as a proxy for market value if the information is deemed reliable.

RBSG Group does not recognise certain asset classes as collateral: for example, short leasehold property and equity shares of the borrowing company. Collateral whose value is correlated to that of the obligor is assessed on a case-by-case basis and, where necessary, over-collateralisation may be required.

RBSG Group uses Industry-standard loan and security documentation wherever possible. Non standard documentation is typically prepared by external lawyers on a case-by-case basis. RBSG Group's business and credit teams are supported by in-house specialist documentation teams.

The existence of collateral has an impact on provisioning. Where RBSG Group no longer expects to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for a provision. No impairment provision is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Wholesale market exposures

RBSH Group receives collateral for reverse repurchase transactions and for derivatives, typically in the form of cash, quoted debt securities or equities. The risks inherent in both types of transaction are further mitigated through master bilateral netting arrangements. Industry standard documentation such as master repurchase agreements and credit support annexes accompanied by legal opinions is used for financial collateral taken as part of trading activities.

	2012 (1)	2011 (1)	2010 (1)
	€bn	€bn	€bn
Reverse repurchase agreements	0.1	9.4	8.2
Securities received as collateral	0.1	9.4	8.1
Derivative assets gross exposure (2)	7.6	19.1	28.3
Counterparty netting	(0.2)	(0.8)	(2.9)

Notes:

(1) Measured on a loans and advances basis.

(2) Cash collateral held against derivative exposures in 2012 was €0.8 billion (2011 - €1.0 billion, 2010 - €1.8 billion).

Credit risk: continued

Early problem identification and problem debt management

Wholesale customers

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

Early problem recognition

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

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

Watchlist

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

Once on the Watchlist process, customers come under heightened scrutiny. The relationship strategy is reassessed by a forum of experienced credit, portfolio management and remedial management professionals within the division. In accordance with Group-wide policies, a number of mandatory actions will be taken, including a review of the customer's credit grade and facility security documentation. Other appropriate corrective action is taken when circumstances emerge that may affect the customer's ability to service its debt. Such circumstances include deteriorating trading performance, an imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

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

At 31 December 2012, exposures to customers reported as Watchlist Red and managed within the divisions totalled €0.6 billion (2011 - €1.1 billion).

Strategies that are available within divisions include granting the customer various types of concessions. Any decision to approve a concession will be a function of the division's specific country and sector appetite, the key credit metrics of the customer, the market environment and the loan structure/security. Refer to the section below on 'Wholesale renegotiations'.

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

The following table shows a sector breakdown of credit risk assets of Watchlist Red counterparties under GRG management:

Watchlist Red credit risk assets under GRG management	2012 €m	2011 €m
Property	4	436
Transport	212	210
Retail and leisure	99	91
Services	4	145
Other	122	423
Total	441	1,305

RBSG Global Restructuring Group (GRG)

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

Wholesale renegotiations

Loan modifications take place in a variety of circumstances including but not limited to a customer's current or potential credit deterioration. Where the contractual payment terms of a loan have been changed because of the customer's financial difficulties, it is classified as 'renegotiated' in the wholesale portfolio.

Credit risk: Early problem identification and problem debt management continued

Loans modified in the normal course of business where there is no evidence of financial difficulties and any changes to terms and conditions are within acceptable credit parameters, within credit risk appetite and/or reflective of improving conditions for the customer in the credit markets, are not considered to have been renegotiated.

A number of options are available to RBSG Group when a wholesale customer is facing financial difficulties and corrective action is deemed necessary. Such actions are tailored to the individual circumstances of the customer. The aim of such actions is to assist the customer in restoring its financial health and to minimise risk to RBSG Group. To ensure that the renegotiations are appropriate for the needs and financial profile of the customer, RBSG Group requires minimum standards to be applied when assessing, recording, monitoring and reporting this type of activity.

Wholesale renegotiations involve the following types of concessions:

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

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

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

In addition, RBSG Group may offer a temporary covenant waiver, a recalibration of covenants and/or a covenant amendment to cure a potential or actual covenant breach. Such relief is usually granted in exchange for fees, increased margin, additional security, or a reduction in maturity profile of the original loan. These financial covenant concessions are monitored internally, but are not included in the renegotiated loans data (when this is the sole concession granted to a customer) as we believe that such concessions are qualitatively different from other renegotiations: The loan's payment terms are unchanged. Covenant concessions provide an early warning indicator rather than firm evidence of a significant deterioration in credit quality.

Covenant waivers and amendments are predominantly undertaken prior to transfer to GRG. The vast majority of the other types of renegotiations undertaken by RBSG Group take place within GRG. Forgiveness of debt and exchange for equity is only available to customers in the GRG.

Loans may be renegotiated more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan’s terms. Where renegotiation is no longer viable, RBSG Group will consider other options such as the enforcement of security and or insolvency proceedings.

Provisioning for wholesale renegotiated customers

Wholesale renegotiations are predominantly individually assessed and are not therefore segregated into a separate risk pool.

Provisions for renegotiated wholesale loans are assessed in accordance with RBSG Group’s normal provisioning policies (refer to Impairment loss provision methodology on page 58). For the non-performing population, provisions on exposures greater than £1 million are individually assessed by GRG. The provision required is calculated based on the difference between the debt outstanding and the present value of the estimated future cash flows. Exposures smaller than £1 million are deemed not to be individually significant and are assessed collectively by the originating division. Within the performing book, latent loss provisions are held for those losses that are incurred, but not yet identified.

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

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

In the case of non-performing loans that are renegotiated, the loan impairment provision assessment almost invariably takes place prior to the renegotiation. The quantum of the loan impairment provision may change once the terms of the renegotiation are known, resulting in an additional provision charge or a release of the provision in the period the renegotiation takes place.

The transfer of renegotiated wholesale loans from impaired to performing status follows assessment by relationship managers in GRG. When no further losses are anticipated and the customer is expected to meet the loan’s revised terms, any provision is written off and the balance of the loan returned to performing status.

Credit risk: Early problem identification and problem debt management continued

Performing loans that are renegotiated will be included in the calculation of the latent loss provisions. To the extent that the renegotiation event has affected the customer's estimated probability of default or loss given default, this will be reflected in the underlying calculation.

Recoveries and active insolvency management

The ultimate outcome of a renegotiation strategy is unknown at the time of execution. It is highly dependent on the cooperation of the borrower and the continued existence of a viable business. The following are generally considered to be options of last resort:

- Enforcement of security or otherwise taking control of assets - Where RBSG Group holds collateral or other security interest and is entitled to enforce its rights, it may take ownership or control of the assets. RBSG Group's preferred strategy is to consider other possible options prior to exercising these rights.

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

Impairment loss provision methodology

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

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

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

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

Individually assessed provisions - provisions required for individually significant impaired assets are assessed on a case-by-case basis. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate.

Future cash flows are estimated through a case-by-case analysis of individually assessed assets.

This assessment takes into account the benefit of any guarantees or other collateral held. The value and timing of cash flow receipts are based on available estimates in conjunction with facts available at that time. Timings and amounts of cash flows are reviewed on subsequent assessment dates, as new information becomes available. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.

Collectively assessed provisions - provisions on impaired credits below an agreed threshold are assessed on a portfolio basis to reflect the homogeneous nature of the assets. RBSG Group segments impaired credits in its collectively assessed portfolios according to asset type, such as credit cards, personal loans, mortgages and smaller homogenous wholesale portfolios, such as business or commercial banking. The provision is determined based on a quantitative review of the relevant portfolio, taking account of the level of arrears, the value of any security, historical and projected cash recovery trends over the recovery period. The provision also incorporates any adjustments that may be deemed appropriate given current economic and credit conditions. Such adjustments may be determined based on: a review of the current cash collections profile performance against historical trends; updates to metric inputs including model recalibrations; and monitoring of operational processes used in managing exposures including the time taken to process non-performing exposures. As a result of the Transfers to RBS plc and the disposal of Non-Core operations, RBSH Group has no material collectively assessed provisions as at 31 December 2012.

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

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

- the probability that the performing customer will default - historical loss experience, adjusted, where appropriate, to take into account current economic and credit conditions; and

- the emergence period, defined as the period between an impairment event occurring and a loan being identified and reported as impaired.

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

Refer to page 73 for analysis of impaired loans, related provisions and impairments.

Balance sheet analysis

Business review Risk and balance sheet management continued

Balance sheet analysis

Sector and geographic concentration

The following tables provide an analysis of credit concentration of financial assets by sector and geography. Geographical regions are based on the location of the office.

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

	Loans and advances	Securities	Derivatives	Other (1)	Total	Netting and offset (2)
2012	€m	€m	€m	€m	€m	€m
Central and local government	891	7,783	55	2	8,731	11
Finance (3)	16,424	15,347	6,657	18	38,446	1,072
Residential mortgages	283	-	-	-	283	-
Personal lending	-	-	-	-	-	-
Property	76	-	63	-	139	1
Construction	20	-	9	-	29	-
Manufacturing	1,370	182	18	-	1,570	1
Service industries and business activities	2,708	305	753	11	3,777	-
Agriculture, forestry and fishing	4	-	-	-	4	-
Finance lease and instalment credit	109	-	-	-	109	-
Interest accruals	(9)	270	-	-	261	-
Total gross of provisions	21,876	23,887	7,555	31	53,349	1,085
Provisions	(341)	(105)	-	-	(446)	-
Total	21,535	23,782	7,555	31	52,903	1,085
Comprising:						
Derivative balances						171
Derivative collateral						914
						1,085
2011						
Central and local government	1,062	11,405	103	50	12,620	-
Finance (3)	32,187	28,493	16,774	1,173	78,627	3,064
Residential mortgages	1,125	-	-	-	1,125	-
Personal lending	318	-	-	-	318	-
Property	701	-	125	-	826	-
Construction	1,049	25	109	-	1,183	-
Manufacturing	7,200	21	554	-	7,775	-
Service industries and business activities	14,144	2,313	1,373	224	18,054	43
Agriculture, forestry and fishing	123	-	98	-	221	-
Finance lease and instalment credit	102	-	2	-	104	-
Interest accruals	192	583	-	-	775	-

Total gross of provisions	58,203	42,840	19,138	1,447	121,628	3,107
Provisions	(1,572)	(102)	-	-	(1,674)	-
Total	56,631	42,738	19,138	1,447	119,954	3,107

For notes to this table refer to page 61.

Business review Risk and balance sheet management continued

Balance sheet analysis: Sector and geographic concentration continued

2010	Loans and advances €m	Securities €m	Derivatives €m	Other (1) €m	Total €m	Netting and offset (2) €m
Central and local government	1,544	26,038	383	7	27,972	-
Finance (3)	39,786	45,413	25,194	3,858	114,251	7,865
Residential mortgages	984	-	-	-	984	-
Personal lending	427	72	-	-	499	-
Property	1,110	53	142	-	1,305	-
Construction	921	46	47	-	1,014	-
Manufacturing	9,213	170	404	-	9,787	-
Service industries and business activities	18,297	1,874	2,102	-	22,273	2
Agriculture, forestry and fishing	165	-	-	-	165	-
Finance lease and instalment credit	54	-	-	-	54	-
Interest accruals	272	1,228	-	-	1,500	-
Total gross of provisions	72,773	74,894	28,272	3,865	179,804	7,867
Provisions	(1,572)	-	-	-	(1,572)	-
Total	71,201	74,894	28,272	3,865	178,232	7,867

Notes:

(1) Includes settlement balances.

(2) This shows the amount by which RBSH Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give RBSH Group a legal right to set off the financial asset against a financial liability due to the same counterparty. In addition, RBSH Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. RBSH Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

(3) Includes reverse repurchase agreements of €0.1 billion (2011 - €9.4 billion; 2010 - €8.2 billion).

Loans and advances to banks and customers by geographical region

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

	2012 €m	2011 €m	2010 €m
Loans and advances to banks			
Netherlands	6,514	8,648	6,072
US	391	1,458	280
Rest of world	8,250	16,947	20,353
	15,155	27,053	26,705

Loans and advances to customers			
Netherlands	1,518	6,164	9,621
US	-	874	1,531
Rest of world	4,862	22,540	33,344
	6,380	29,578	44,496
Total	21,535	56,631	71,201

Business review Risk and balance sheet management continued

Balance sheet analysis continued

Asset quality

The asset quality analysis presented below is based on RBSG Group's internal asset quality ratings which have ranges for the probability of default, as set out below. Customers are assigned credit grades, based on various credit grading models that reflect the key drivers of default for the customer type. All credit grades across RBSG Group map to both a RBSG Group level asset quality scale, used for external financial reporting, and a master grading scale for wholesale exposures used for internal management reporting across portfolios. Debt securities are analysed by external ratings agencies and are therefore excluded from the following table and are set out on page 64.

Asset quality band	Probability of default range
AQ1	0% - 0.034%
AQ2	0.034% - 0.048%
AQ3	0.048% - 0.095%
AQ4	0.095% - 0.381%
AQ5	0.381% - 1.076%
AQ6	1.076% - 2.153%
AQ7	2.153% - 6.089%
AQ8	6.089% - 17.222%
AQ9	17.222% - 100%
AQ10	100%

		Loans and advances									
	Cash and balances at central banks	Banks			Customers						
		Reverse repos	Derivative cash collateral	Other	Reverse repos	Derivative cash collateral	Other	Settlement balances	Derivatives	Other financial instruments	Commitmen
2012	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	
AQ1	2,068	3	737	961	1	246	1,144	26	330	-	1,48
AQ2	-	-	264	6	-	-	192	-	577	-	1,32
AQ3	226	-	119	97	-	143	860	1	175	-	1,1
AQ4	-	-	310	334	-	40	1,713	-	1,365	-	80
AQ5	-	-	80	173	-	27	553	-	401	-	18
AQ6	-	-	-	1	-	-	839	3	11	-	10
AQ7	-	3	-	137	-	-	201	-	12	-	[illegible]
AQ8	-	-	-	26	4	-	75	-	31	-	[illegible]
AQ9	-	-	-	17	-	-	138	-	1	-	27
AQ10	-	-	-	-	-	-	27	-	28	-	[illegible]
Balances with RBSG	-	62	-	11,825	-	-	-	1	4,624	-	2

Group											
Past due	-	-	-	-	-	-	12	-	-	-	
Impaired	-	-	-	-	-	-	506	-	-	-	
Impairment provision	-	-	-	-	-	-	(341)	-	-	-	
Total	2,294	68	1,510	13,577	5	456	5,919	31	7,555	-	5,7[illegible]

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Business review Risk and balance sheet management continued

Balance sheet analysis: Asset quality continued

	Cash and balances at central banks	Loans and advances		Settlement balances	Derivatives	Other financial instruments	Commitments	Contingent liabilities	Total
		Banks	Customers						
2011	€m	€m	€m	€m	€m	€m	€m	€m	€m
AQ1	12,184	9,982	7,257	81	4,267	-	8,565	9,529	51,865
AQ2	157	322	2,533	-	1,091	-	4,052	2,543	10,698
AQ3	206	407	3,760	614	1,032	-	2,895	2,853	11,767
AQ4	-	406	6,811	8	801	-	3,657	3,155	14,838
AQ5	55	498	3,039	45	461	-	1,280	1,865	7,243
AQ6	-	84	2,061	-	55	-	383	404	2,987
AQ7	-	382	1,965	1	99	-	328	519	3,294
AQ8	7	12	356	-	236	-	20	28	659
AQ9	-	91	842	-	4	-	857	1,003	2,797
AQ10	-	2	218	4	30	-	276	26	556
Balances with RBSG Group	-	14,858	-	1,855	11,062	-	65	1,272	29,112
Past due	-	2	385	-	-	-	-	-	387
Impaired	-	52	1,878	-	-	494	-	-	2,424
Impairment provision	-	(45)	(1,527)	-	-	(31)	-	-	(1,603)
Total	12,609	27,053	29,578	2,608	19,138	463	22,378	23,197	137,024
2010									
AQ1	7,923	12,758	11,047	3,174	12,200	235	13,289	4,844	65,470
AQ2	15	587	2,620	122	1,444	-	3,622	1,217	9,627
AQ3	53	732	4,431	11	1,140	-	4,168	2,687	13,222
AQ4	216	565	9,001	(1)	1,402	-	7,604	4,114	22,901
AQ5	111	2,502	7,069	5	945	-	4,066	1,757	16,455
AQ6	-	170	2,956	1	80	-	943	275	4,425
AQ7	-	131	2,973	-	229	-	1,129	1,725	6,187
AQ8	-	-	794	-	135	-	2,126	10,786	13,841
AQ9	-	118	1,333	-	193	-	319	509	2,472
AQ10	5	89	1,373	2	257	-	726	170	2,622
Balances with RBSG Group	-	9,039	128	259	10,247	-	2	661	20,336
Past due	-	4	190	-	-	-	-	-	194

Impaired	-	55	2,108	-	-	434	-	-	2,597
Impairment provision	-	(45)	(1,527)	-	-	(33)	-	-	(1,605)
Total	8,323	26,705	44,496	3,573	28,272	636	37,994	28,745	178,744

In 2012, RBSH Group implemented material updates to certain models, including those used for sovereign and financial institution counterparties, to incorporate more recent data and reflect new regulatory requirements applicable to wholesale internal ratings based modelling. This has resulted in an overall migration to higher AQ bands. However, it is not practicable to quantify the impact of model updates on individual asset quality bands. RBSH Group had modified various risk frameworks, including risk appetite framework and latent loss assessment in anticipation of these changes. Further updates, primarily of models used for the corporate counterparties, are planned for 2013. The AQ composition of the corporate portfolio has not changed materially during the year.

Business review Risk and balance sheet management continued

Balance sheet analysis continued

Debt securities

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

	Central and local government								
	UK	US	Other	Banks	Other financial institutions	Corporate	Total	Total	Of which ABS (1)
2012	€m	€m	€m	€m	€m	€m	€m	%	€m
AAA	-	-	1,383	143	3,791	18	5,335	23.5%	3,772
AA to AA+	-	1,871	1,657	525	1,542	124	5,719	25.3%	2,026
A to AA-	-	-	1,761	150	595	15	2,521	11.1%	561
BBB- to A-	-	-	972	4,012	3,084	13	8,081	35.7%	7,077
Non-investment grade	-	-	290	316	25	5	636	2.8%	341
Unrated	-	-	-	179	2	182	363	1.6%	-
Total	-	1,871	6,063	5,325	9,039	357	22,655	100.0%	13,777
2011									
AAA	-	-	5,564	2,821	6,285	175	14,845	37.4%	8,755
AA to AA+	-	3,521	1,882	1,215	1,633	57	8,308	21.0%	2,347
A to AA-	-	-	4,846	2,398	1,839	4	9,087	22.9%	3,727
BBB- to A-	-	-	2,504	2,213	484	82	5,283	13.3%	2,383
Non-investment grade	-	-	803	477	349	205	1,834	4.7%	150
Unrated	-	-	2	93	30	163	288	0.7%	-
Total	-	3,521	15,601	9,217	10,620	686	39,645	100.0%	17,362
2010									
AAA	7	2,328	15,405	6,775	7,901	404	32,820	62.7%	14,466
AA to AA+	-	-	929	1,221	2,498	155	4,803	9.2%	2,978
A to AA-	-	-	3,784	944	40	95	4,863	9.3%	824
BBB- to A-	-	-	3,031	628	31	54	3,744	7.2%	49
Non-investment grade	-	-	1,682	1,670	443	1,564	5,359	10.3%	5
Unrated	-	-	-	134	214	323	671	1.3%	67
Total	7	2,328	24,831	11,372	11,127	2,595	52,260	100.0%	18,389

Note:

(1) Asset-backed securities.

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

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

	2012 €bn	2011 €bn	2010 €bn
Securities issued by central and local governments	7.9	19.1	27.2
Securities issued by corporates	0.4	0.7	2.6
Securities issued by banks and other financial institutions	14.4	19.8	22.5
	22.7	39.6	52.3
Asset-backed securities	13.8	17.4	18.4

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

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

The following tables summarise RBSH Group’s net exposures and carrying values of these securities by geography of the underlying assets at 31 December 2012, 2011 and 2010 and by IFRS measurement classification of held for trading (HFT), designated at fair value (DFV), available-for-sale (AFS) and loans and receivables (LAR). Gross exposures represent the principal amounts relating to ABS. Government sponsored or similar RMBS comprises securities that are: (a) guaranteed or effectively guaranteed by the US government, by way of its support for US federal agencies and government sponsored enterprises, or (b) guaranteed by the Dutch government.

Net exposures represent the carrying value after taking account of the hedge protection purchased from monoline insurers and other counterparties, but exclude the effect of counterparty credit valuation adjustments. The hedge provides credit protection of both principal and interest cash flows in the event of default by the counterparty. The value of this protection is based on the underlying instrument being protected.

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 and geographic region in which the underlying mortgage assets are located and the credit

enhancement of 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 provided by monoline insurers. The main category of mortgages that serve as collateral to RMBS held by RBSH Group with related vintages is set on page 67.

Business review Risk and balance sheet management continued

Balance sheet analysis: Asset-backed securities (ABS) continued

Asset-backed securities by product, geography and IFRS measurement classification

2012	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP (2) HFT (3) €m	AFS (4) €m
Gross exposure							
RMBS: government sponsored or similar	-	-	6,583	-	6,583	-	6,583
MBS: covered bond	56	211	7,519	-	7,786	-	7,786
CDOs	-	-	159	-	159	-	159
Other ABS	-	-	628	-	628	-	628
	56	211	14,889	-	15,156	-	15,156
Net exposure							
RMBS: government sponsored or similar	-	-	5,985	-	5,985	-	5,985
MBS: covered bond	59	250	6,720	-	7,029	-	7,029
CDOs	-	-	149	-	149	-	149
Other ABS	-	-	614	-	614	-	614
	59	250	13,468	-	13,777	-	13,777

2011	US €m	UK €m	Other Europe €m	RoW (1) €m	Total €m	FVTP (2) HFT (3) €m	AFS (4) €m
Gross exposure							
RMBS: government sponsored or similar	-	-	7,035	-	7,035	-	7,035
MBS: covered bond	160	242	9,870	-	10,272	-	10,272
CDOs	-	-	184	-	184	-	184
Other ABS	-	-	1,603	25	1,628	-	1,628
	160	242	18,692	25	19,119	-	19,119
Net exposure							
RMBS: government sponsored or similar	-	-	6,635	-	6,635	-	6,635
MBS: covered bond	162	250	8,578	-	8,990	-	8,990
CDOs	-	-	165	-	165	-	165
Other ABS	-		1,547	25	1,572	-	1,572
	162	250	16,924	25	17,362	-	17,362

2010

Gross exposure							
RMBS: government sponsored or similar	-	-	7,449	-	7,449	-	7,449
MBS: covered bond	160	242	9,887	-	10,289	-	10,289
CDOs	-	-	163	-	163	9	154
Other ABS	-	-	2,229	31	2,260	-	2,260
RMBS: government sponsored or similar	160	242	19,728	31	20,161	9	20,152
Net exposure							
RMBS: government sponsored or similar	-	-	6,909	-	6,909	-	6,909
MBS: covered bond	164	242	8,724	-	9,130	-	9,130
CDOs	-	-	146	-	146	-	146
Other ABS	-	-	2,173	31	2,204	-	2,204
MBS: covered bond	164	242	17,952	31	18,389	-	18,389

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

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Balance sheet analysis: Asset-backed securities (ABS) continued

The table below summarises the rating levels of ABS carrying values. Credit ratings are based on those from rating agencies Standard & Poor's (S&P), Moody's and Fitch and have been mapped onto the S&P scale.

2012	AAA €m	AA to AA+ €m	A to AA- €m	BBB- to A- €m	Non-investment grade €m	Unrated €m	Total €m
RMBS: government sponsored or similar	2,988	1,512	246	1,214	25	-	5,985
MBS: covered bond	784	125	190	5,763	167	-	7,029
CDOs	-	-	-	-	149	-	149
Other ABS	-	389	125	100	-	-	614
	3,772	2,026	561	7,077	341	-	13,777
2011							
RMBS: government sponsored or similar	4,979	1,474	157	-	25	-	6,635
MBS: covered bond	3,102	454	3,069	2,365	-	-	8,990
CDOs	-	-	22	18	125	-	165
Other ABS	674	419	479	-	-	-	1,572
	8,755	2,347	3,727	2,383	150	-	17,362
2010							
RMBS: government sponsored or similar	5,136	1,774	-	-	-	-	6,910
MBS: covered bond	8,241	414	474	-	-	-	9,129
CDOs	-	-	127	19	-	-	146
Other ABS	1,089	790	223	30	5	67	2,204
	14,466	2,978	824	49	5	67	18,389

Key points

- Carrying values of asset-backed securities decreased by €3.6 billion during 2012 due to the maturity and sale of positions.

- The RMBS held for trading positions fully matured or were sold off in 2010. For the composition of the remaining AFS portfolio, refer to page 75. The available-for-sale RMBS government sponsored or similar positions are backed by mortgages covered by the Dutch mortgage guarantee scheme.

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

Business review Risk and balance sheet management continued

Balance sheet analysis continued

Derivatives

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

	2012					
	0 - 3 months €m	3 - 6 months €m	6 - 12 months €m	1 - 5 years €m	Over 5 years €m	Gross assets €m
AQ1	22	2	11	122	173	330
AQ2	4	-	136	85	352	577
AQ3	3	2	2	17	151	175
AQ4	19	6	12	792	536	1,365
AQ5	2	1	11	81	306	401
AQ6	-	1	-	9	1	11
AQ7	1	-	2	8	1	12
AQ8	1	-	-	11	19	31
AQ9	-	1	-	-	-	1
AQ10	-	-	-	28	-	28
Balances with RBSG Group	445	344	352	1,922	1,561	4,624
	497	357	526	3,075	3,100	7,555
Counterparty mtm netting						(171)
Cash collateral held against derivative exposures						(807)
Net exposure						6,577

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

	1,819	1,146	2,022	7,152	6,999	19,138	5,606	1,117	2,608	13,164	5,777	28,272
Counterparty mtm netting						(813)						(2,864)
Cash collateral held against derivative exposures						(1,033)						(1,786)
Net exposure						17,292						23,622

Business review Risk and balance sheet management continued

Balance sheet analysis: Derivatives continued

The table below analyses the fair value of RBSH Group's derivatives by type of contract. Master netting arrangements in respect of mark-to-market (mtm) positions and collateral shown below do not result in a net presentation in the Group's balance sheet under IFRS.

	2012							2011			2010		
	Notional												
	Euro	GBP	USD	Other	Total	Asset	Liabilities	Notional	Assets	Liabilities	Notional	Assets	Liabilities
Contract type	€bn	€bn	€bn	€bn	€bn	€m	€m	€bn	€m	€m	€bn	€m	€m
Exchange rate	1	97	14	17	129	1,678	1,793	196	6,533	6,085	321	7,745	7,221
Interest rate	53	75	3	9	140	4,891	7,257	305	7,183	10,096	594	12,625	13,887
Credit derivatives	1	2	-	-	3	197	133	11	713	650	99	1,597	4,413
Equity and commodity	-	-	1	-	1	789	461	19	4,709	3,037	187	6,305	10,152
						7,555	9,644		19,138	19,868		28,272	35,673

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

	0 - 3 months	3 - 6 months	6 - 12 months	1 - 5 years	Over 5 years	Gross assets	Counterparty mtm netting	Net Exposure
2012	€m	€m	€m	€m	€m	€m	€m	€m
Exchange rate	346	221	224	490	397	1,678	(16)	1,662
Interest rate	100	53	198	1,960	2,580	4,891	(124)	4,767
Credit derivatives	2	-	-	144	51	197	(31)	166
Equity and commodity	49	83	104	481	72	789	-	789
	497	357	526	3,075	3,100	7,555		7,384
Cash collateral held against derivative exposures								(807)
Net exposure								6,577
2011								
Exchange rate	1,102	621	1,127	2,005	1,678	6,533	(48)	6,485
Interest rate	205	95	495	2,632	3,756	7,183	(579)	6,604
Credit derivatives	13	2	8	95	595	713	(28)	685
Equity and commodity	499	429	392	2,419	970	4,709	(158)	4,551
	1,819	1,147	2,022	7,151	6,999	19,138		18,325
Cash collateral held against derivative exposures								(1,033)
Net exposure								17,292

2010

Exchange rate	2,018	629	777	3,182	1,139	7,745	(389)	7,356
Interest rate	2,297	187	327	6,008	3,806	12,625	(1,399)	11,226
Credit derivatives	514	3	32	372	676	1,597	(1,076)	521
Equity and commodity	777	298	1,472	3,602	156	6,305	-	6,305
	5,606	1,117	2,608	13,164	5,777	28,272		25,408
Cash collateral held against derivative exposures								(1,786)
Net exposure								23,622

Balance sheet analysis continued

Credit derivatives

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

	2012				2011				2010			
	Notional		Fair value		Notional		Fair value		Notional		Fair value	
	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold
	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn	€bn
Client led trading and residual risk	160	167	35	(3)	701	185	(1)	(2)	3,403	45	(45)	(1)
Credit hedging – banking book	-	-	-	-	1,088	460	(16)	3	9,129	20,337	(153)	94
Credit hedging – trading book												
- Credit and mortgage markets	981	476	56	(54)	2,348	2,461	193	382	10,216	3,648	2,186	1,308
- Other	251	373	15	(21)	194	-	(66)	-	384	27	(19)	-
	1,392	1,016	106	(78)	4,331	3,106	110	383	23,132	24,057	1,969	1,401

Business review Risk and balance sheet management continued

Balance sheet analysis continued

Risk elements in lending (REIL), provisions and AFS reserves

REIL comprises impaired loans and accruing loans past due 90 days or more as to principal or interest. Impaired loans are all loans (including renegotiated loans) for which an impairment provision has been established; for collectively assessed loans, impairment loss provisions are not allocated to individual loans and the entire portfolio is included in impaired loans. Accruing loans past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

Sector and geographical regional analyses

The following tables analyse gross loans and advances to customers and the related debt management measures and ratios by sector and geography (by location of office). Gross loans, REIL and provisions exclude amounts relating to businesses held for disposal, consistent with the balance sheet presentation required by IFRS.

	2012							
	Gross Loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	891	-	-	0.0%	0.0%	0.0%	-	-
Finance	1,269	61	14	4.8%	23.0%	1.1%	43	213
Residential mortgages	283	41	12	14.5%	29.3%	4.2%	17	34
Property	76	54	35	71.1%	64.8%	46.1%	(21)	46
Construction	20	-	-	0.0%	0.0%	0.0%	3	10
Manufacturing	1,370	138	72	10.1%	52.2%	5.3%	33	64
Service industries and other business activities	2,708	209	171	7.7%	81.8%	6.3%	26	64
Agriculture, forestry and fishing	4	3	2	75.0%	66.7%	50.0%	-	1
Finance leases and instalment credit	109	-	-	0.0%	0.0%	0.0%	-	-
Interest accruals	(9)	-	-	0.0%	0.0%	0.0%	-	-
Latent	-	-	35	0.0%	0.0%	0.0%	(86)	-
	6,721	506	341	7.5%	67.4%	5.1%	15	432
of which:	-	-	-				-	-
- Netherlands	1,672	253	155	15.1%	61.3%	9.3%	6	50
- Overseas	5,049	253	186	5.0%	73.5%	3.7%	9	382
Total	6,721	506	341	7.5%	67.4%	5.1%	15	432

	2011							
	Gross loans	REIL €m	Provisions €m	REIL as a %	Provisions as a %	Provisions as a %	Impairment charge	Amounts written-off

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

Business review Risk and balance sheet management continued

Balance sheet analysis: Risk elements in lending (REIL), provisions and AFS reserves continued

	2010							
	Gross loans €m	REIL €m	Provisions €m	REIL as a % of gross loans %	Provisions as a % of REIL %	Provisions as a % gross loans %	Impairment charge €m	Amounts written-off €m
Central and local government	1,544	-	-	-	-	-	66	-
Finance	13,083	570	372	4.4%	65.2%	2.8%	157	46
Residential mortgages	984	54	26	5.5%	48.1%	2.6%	22	1
Personal lending	427	331	290	77.5%	87.7%	68.0%	29	266
Property	1,110	112	62	10.1%	55.4%	5.6%	-	-
Construction	919	8	8	0.9%	98.8%	0.9%	4	2
Manufacturing	9,213	398	260	4.3%	65.3%	2.8%	(253)	1,555
Service industries and business activities	18,297	692	391	3.8%	56.6%	2.1%	17	60
Agriculture, forestry and fishing	165	4	2	2.4%	50.0%	1.0%	1	-
Finance leases and instalment credit	54	-	-	-	-	-	-	-
Interest accruals	227	-	-	-	-	-	-	-
Latent	-	-	116				77	-
	46,023	2,169	1,527	4.7%	70.4%	3.3%	120	1,930
of which:								
- Netherlands	9,844	574	223	5.8%	38.9%	2.3%	80	1,506
- Overseas	36,179	1,595	1,304	4.4%	81.8%	3.6%	40	424
Total	46,023	2,169	1,527	4.7%	70.4%	3.3%	120	1,930

REIL and PPLs summary

The table below analyses REIL between the Netherlands and overseas, based on location of office.

	2012 €m	2011 €m	2010 €m
Impaired loans			
- Netherlands	253	339	445
- Overseas	253	1,591	1,719
	506	1,930	2,164

Accruing loans past due 90 days or more

- Netherlands	-	78	51
- Overseas	-	89	9
	-	167	60
Total REIL	506	2,097	2,224
REIL as a % of gross loans and advances to customers	7.5%	6.8%	4.8%

Potential problem loans

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

	2012	2011	2010
	€m	€m	€m
Potential problem loans	27	220	133

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

Business review Risk and balance sheet management continued

Balance sheet analysis: Risk elements in lending (REIL), provisions and AFS reserves continued

Flow statement

REIL are stated without giving effect to any security held that could reduce the eventual loss should it occur or to any provisions marked. The table below details the movement in REIL.

	Impaired loans			Other loans (1)			REIL		
	Core	Non-Core	Total	Core	Non-Core	Total	Core	Non-Core	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m
At 1 January 2012	858	1,072	1,930	161	6	167	1,019	1,078	2,097
Currency translation and other adjustments	4	6	10	-	-	-	4	6	10
Additions	85	207	292	2	16	18	87	223	310
Transfers	(568)	(281)	(849)	2	(3)	(1)	(566)	(284)	(850)
Disposals and renegotiations	(14)	(187)	(201)	(81)	(3)	(84)	(95)	(190)	(285)
Repayments	(42)	(183)	(225)	(84)	(16)	(100)	(126)	(199)	(325)
Amounts written-off	(257)	(194)	(451)	-	-	-	(257)	(194)	(451)
At 31 December 2012	66	440	506	-	-	-	66	440	506

Note:
(1) Accruing loans past due 90 days or more where an impairment event has taken place but no impairment provision has been recognised. This category is used for fully collateralised non-revolving credit facilities.

Past due analysis

The table below shows loans and advances to customers that were past due at the balance sheet date but not considered impaired.

	2012			2011			2010
	Core	Non-Core	Total	Core	Non-Core	Total	Total
	€m	€m	€m	€m	€m	€m	€m
Past due 1-29 days	12	-	12	20	176	196	51
Past due 30-59 days	-	-	-	1	12	13	42
Past due 60-89 days	-	-	-	2	9	11	40
Past due 90 days or more	-	-	-	161	6	167	60
	12	-	12	184	203	387	193

Provisions and AFS reserves

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

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

Analysis of provisions is set out on page 159 and below.

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

RBSH Group reviews its portfolios of available-for-sale financial assets for evidence of impairment, which includes: default or delinquency in interest or principal payments; significant financial difficulty of the issuer or obligor; and it becoming probable that the issuer will enter bankruptcy or other financial reorganisation. However, the disappearance of an active market because an entity's financial instruments are no longer publicly traded is not evidence of impairment. Furthermore, a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment. Determining whether objective evidence of impairment exists requires the exercise of management judgment. The unrecognised losses on RBSH Group's available-for-sale debt securities are concentrated in its portfolios of mortgage-backed securities. The losses reflect the widening of credit spreads as a result of the reduced market liquidity in these securities and the current uncertain macroeconomic outlook in the US and Europe. The underlying securities remain unimpaired.

Analyses of AFS debt securities and related AFS reserves are set out on page 75.

Business review Risk and balance sheet management continued

Balance sheet analysis: Risk elements in lending (REIL), provisions and AFS reserves continued

Impairment provisions flow statement

The movement in loan impairment provision is shown in the table below.

	2012	2011	2010
	€m	€m	€m
At 1 January	1,572	1,572	5,711
Transfers to disposal groups	(171)	-	(2,377)
Currency translation and other adjustments	(87)	68	212
Disposals	(562)	(45)	-
Amounts written-off	(453)	(397)	(1,943)
Recoveries of amounts previously written-off	12	22	59
Charged/(credited) to the income statement	30	360	(78)
Unwind of discount (recognised in interest income)	-	(8)	(12)
At 31 December	341	1,572	1,572
Individually assessed:			
- banks	-	45	45
- customers	306	1,298	1,261
Collectively assessed	-	123	150
Latent	35	106	116
	341	1,572	1,572

Impairment charge/(credit) analysis

The following table analyses the impairment charge for loans and securities.

	2012	2011	2010
	€m	€m	€m
Latent loss	(86)	(13)	(120)
Collectively assessed	17	25	101
Individually assessed	99	348	(59)
Charge to income statement continuing operations	30	360	(78)
Loans to banks	15	-	(15)
Loans to customers	15	360	(63)
(Recoveries)/recharge to RBS plc under APS back-to-back agreement	(13)	(58)	138
Securities	48	1,463	7
Charge to income statement continuing operations	65	1,765	67
Charge to income statement discontinuing operations	5	9	45
Charge to income statement	70	1,774	112
Charge relating to customer loans as a % of gross customer loans (1)	0.2%	1.1%	(0.2)%

Note:
(1) Customer loan impairment charge as a percentage of gross loans and advances to customers excluding reverse repurchase agreements.

	2012			2011			2010
	Core	Non-Core	Group	Core	Non-Core	Group	Group
	€m	€m	€m	€m	€m	€m	€m
Loan impairment losses							
- customers (1)	(17)	19	2	291	11	302	75
- banks	15	-	15	-	-	-	(15)
	(2)	19	17	291	11	302	60
Impairment losses on debt securities	37	11	48	1,463	-	1,463	7
Charge to income statement continuing operations	35	30	65	1,754	11	1,765	67
Charge to income statement discontinuing operations	-	5	5	-	9	9	45

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

Business review Risk and balance sheet management continued

Balance sheet analysis: Risk elements in lending (REIL), provisions and AFS reserves continued

Available-for-sale debt securities and reserves

The table below analyses available-for-sale (AFS) debt securities by issuer and related AFS reserves net of tax, relating to securities issued by governments and other entities by country.

	2012					2011					2010				
	Govern-ment	ABS	Other	Total	AFS Reserve	Govern-ment	ABS	Other	Total	AFS Reserve	Govern-ment	ABS	Other	Total	AFS Reserv
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€
Netherlands	714	6,039	172	6,925	(602)	746	6,764	170	7,680	(399)	3,526	7,113	171	10,810	(720
Spain	45	5,871	-	5,916	(1,491)	39	7,623		7,662	(1,858)	45	7,838	-	7,883	(1,143
Germany	1,812	300	54	2,166	(3)	4,739	791	131	5,661	(13)	6,680	1,331	132	8,143	(25
United States	1,872	59	9	1,940	(44)	2,485	162	41	2,688	63	2,294	164	124	2,582	4
France	529	635	9	1,173	(60)	1,967	623	9	2,599	(104)	2,729	623	5	3,357	(50
Italy	501	149	-	650	(116)	842	190	-	1,032	(292)	1,050	196	-	1,246	(99
Belgium	1,006	-	-	1,006	(54)	879	-	-	879	(139)	877	-	-	877	(47
India	-	-	-	-	-	699	-	109	808	(4)	636	-	161	797	2
Austria	367	184	110	661	(39)	329	178	156	663	(71)	314	60	154	528	(23
Denmark	-	-	-	-	-	504	-	-	504	-	730	-	-	730	
China	214	-	27	241	-	471	-	-	471	1	499	-	1	500	(1
Hong Kong	-	-	-	-	-	467	-	-	467	-	759	-	7	766	2
Greece	-	-	-	-	-	373	-	-	373	-	1,038	-	-	1,038	(600
Sweden	35	-	4	39	-	34	289	-	323	(2)	34	312	-	346	(2
Ireland	156	209	-	365	(35)	122	176	-	298	(95)	115	170	-	285	(75
United Kingdom	-	250	11	261	(5)	-	250	8	258	(27)	-	242	8	250	(21
Romania	-	-	-	-	-	207	-	-	207	-	302	-	-	302	(5
Malaysia	-	-	-	-	-	194	-	-	194	-	193	-	-	193	
Portugal	88	81	-	169	(41)	68	109	-	177	(116)	107	123	-	230	(41
Other	90	-	10	100	(2)	911	207	331	1,449	(9)	1,582	217	220	2,019	314
Total	7,429	13,777	406	21,612	(2,492)	16,076	17,362	955	34,393	(3,065)	23,510	18,389	983	42,822	(2,530

Key points

- RBS Holdings N.V. holds €21.6 billion of debt securities classified as available-for-sale, the majority of which forms part of the Treasury liquidity buffer. Of the portfolio, €7.4 billion is OECD government issued debt, comprising mainly (€5.3 billion) exposures to European issuers.

- In the first half of 2012, as part of Private Sector Involvement in the Greek government bail-out, the vast majority of this portfolio was exchanged for Greek sovereign debt and European Financial Stability Facility notes; the Greek sovereign debt received in the exchange was sold. Ireland, Italy, Portugal and Spain are facing less acute fiscal difficulties and RBSH Group's sovereign exposures to these countries were not considered impaired at 31 December 2012.

- Further positions in financial instruments comprise €13.8 billion of mortgage and other asset-backed securities. Included are €5.9 billion residential mortgage covered bonds the majority of which originated in Spain and €6.0 billion residential mortgage-backed securities covered by the Dutch mortgage guarantee scheme. Unrealised losses relating to the residential mortgage-backed securities covered by the Dutch mortgage guarantee, increased during 2012 due to rating downgrades.

Country risk

Country risk

Introduction

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

External environment

Country risk, notably in the eurozone, remained elevated in 2012, particularly in the first half of the year. Economic growth projections were lowered - predominantly for Europe but also for a number of major emerging markets. However, important first steps towards achieving longer-term stabilisation in the eurozone led to some notable easing of crisis risks. Growth data from major non-European economies such as China were more encouraging towards the end of the year. The ability of policymakers to tackle fiscal challenges and restore confidence and growth in both the US and Europe will be a key factor in determining the pace of recovery.

Eurozone risks

Eurozone risks continued to dominate, as concerns about the impact of banking sector problems on government balance sheets led to further capital flight from periphery countries and a rise in sovereign bond yields until August, particularly for Spain. To break the feedback loop between banks and their sovereigns, eurozone leaders agreed at their June summit that the European Stability Mechanism (ESM), the eurozone's permanent crisis fund, could lend to banks directly once a single eurozone-wide banking regulator had been established. They also approved the provision by the ESM of significant financial support to Spain to recapitalise its banks.

In the second half of the year, the ESM became fully operational and the European Central Bank (ECB) announced a major new facility, Outright Monetary Transactions. This facility allows secondary market purchases by the ECB of bonds issued by eurozone sovereigns that are subject to a European Union (EU)/International Monetary Fund (IMF) support programme. Following these steps, sovereign bond yields fell markedly.

Meanwhile, in Greece, private sector claims on the government were restructured in early 2012, but political risks remained acute as two successive parliamentary elections eventually resulted in a narrow victory for the pro-bailout New Democracy party. As the electoral process delayed policy implementation and the recession, contrary to earlier expectations, deepened further, additional reforms became necessary and the European Commission, the IMF and the ECB (known collectively as the Troika) further eased Greece's targets.

Elsewhere, Ireland continued to make progress towards targets set out in its Troika programme, notably allowing the government to resume a degree of market financing. Talks with the European authorities on ways to relieve the government of some of the costs of past banking sector support continued, resulting in a favourable restructuring of the Anglo Irish promissory note in early 2013, reducing related fiscal costs somewhat. Notwithstanding these developments, Irish growth remained very weak and reliant on external demand. Portugal also made progress in a number of areas, though had greater structural constraints to address to boost longer-term growth prospects. Towards the end of the year, Cyprus also entered negotiations with the EU and IMF on a support programme. The eurozone as a whole entered recession in the second half of the year, although divergence within the currency union continued, with the core considerably stronger than the periphery.

Emerging markets

Emerging markets performed better on the whole. In developing Asia, the economies of China and India both continued to slow from a strong base, but risks remained held in check by healthy external balance sheets.

Emerging countries in Europe started to be affected by very weak growth in the eurozone, with the most export-focused economies being worst hit. However, countries that took significant action in the wake of the financial crisis to stabilise their banking sectors, saw an easing of risk. Turkey was upgraded by one rating agency to investment grade.

General political instability seen in the Middle East and North Africa in 2011 moderated in 2012 in most countries except Syria, although transition to democratic rule was only partial in some cases. Excluding Bahrain, Gulf Cooperation Council countries were generally more stable, underpinned by high oil prices.

Latin America continued to be characterised by greater stability, due to generally healthier sovereign balance sheets. However, growth prospects deteriorated because of weaker external demand, notably in the region's largest economy, Brazil.

Outlook

Overall, the outlook for 2013 remains challenging with risks likely to remain elevated but divergent. Much will depend on the success of EU efforts to contain contagion from the sovereign crisis (where downside risks are high) and on whether growth headwinds in larger advanced economies, particularly the US and Japan, persist. Emerging market balance sheet risks remain lower, despite structural and political constraints, but it is expected that these economies will continue to be affected by events elsewhere through financial markets and trade channels.

Country risk continued

Governance, monitoring and management

All country exposures in RBSH Group are covered by RBSG Group's country risk framework and a further set of specific RBSH Group country limits.

The RBSG Group country risk framework is set by the RBSG Group Executive Risk Forum (ERF), which has delegated authority to the RBSG Group Country Risk Committee (GCRC) to manage exposures within the framework and deal with any limit breaches, with escalation where needed to ERF. Under this framework, exposures to all countries are monitored. Countries with material exposures are included in RBSG Group's country risk Watchlist process to identify emerging issues and facilitate the development of mitigation strategies. Detailed portfolio reviews are undertaken on a regular basis to ensure that country portfolio compositions remain aligned to RBSG Group's country risk appetite in light of evolving economic and political developments.

Limits on total exposure are set for individual countries based on a risk assessment taking into account the country's economic and political situation and outlook, as well as RBSG Group's portfolio composition in that country. Sub-limits are set on medium-term (greater than one year) exposure since this exposure can, by nature, not be reduced as rapidly as short-term exposure in the event of deterioration of a country's creditworthiness.

During 2012, in addition to all emerging markets and the vulnerable eurozone countries, RBSG Group brought nearly all advanced countries under country limits. The exceptions were the UK (and related European special territories of Guernsey, Jersey, the Isle of Man and Gibraltar) and the US, given their home country status.

Also in 2012, an enhanced country risk appetite framework was introduced. RBSG Group's risk appetite for a particular country is now guided by global risk appetite, the country's internal rating and strategic importance to the RBSG Group, the portfolio composition by tenors and clients, an assessment of the potential for losses arising from a number of possible key country risk events, and other country-specific considerations such as funding profile, risk/return analysis, business opportunities and reputational risk. The actual country limits continue to be set by GCRC (or the ERF above certain benchmark levels).

Further enhancements included improved divisional country risk operating models and the implementation of a new sovereign rating model.

Specific RBSH Group country limits are set by the RBSH Group Risk and Control Committee, which reports to the RBSH Managing Board. These limits are capped by the overall RBSG Group limits, and were based on sovereign ratings and RBSH Group's capital until November 2012.

Significant migrations of exposure from RBSH Group to RBS plc on a country-by-country basis in the course of the year led RBSH Group to reformulate its country limits.

In December 2012, the RBSH Group country limits were reduced to leave only a small amount of headroom for countries where exposures are on further run-off while allowing sufficient room for a dozen 'active' countries from which migration will take place during 2013. Exempt from RBSH Group country limits are only the exposures to the Netherlands (RBSH Group home country), the UK and the US.

Eurozone troubles preparedness

An RBSG Group executive steering group is driving eurozone troubles preparedness. Its agenda in 2012 included operational preparations for possible sovereign defaults and/or eurozone exits. The steering group also considered initiatives to determine and reduce redenomination risk. Further actions to mitigate risks and strengthen control in the eurozone typically included taking guarantees or insurance, updating collateral agreements, and tightening certain credit pre-approval processes.

During 2012, total RBSH Group asset exposures to the eurozone periphery countries decreased by 37% to €8.5 billion, with most of this reduction seen in Spain. The estimated remaining funding mismatch at risk of redenomination was €6.5 for Spain (largely related to AFS bond holdings in the RBSH Group liquidity portfolio) and €0.5 billion for Italy and Ireland each at 31 December 2012. The net positions at year end in Portugal, Cyprus and Greece were minimal.

Credit default swaps

RBSG Group uses credit default swap (CDS) contracts to service customer activity as well as to manage counterparty and country exposure. The latter is done to hedge portfolios or specific exposures. This may give rise to maturity mismatches between the underlying exposure and the CDS contract, as well as between bought and sold CDS contracts on the same reference entity. CDS positions are monitored on a daily basis as part of regular market risk management.

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

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

Country risk continued

Country risk exposure

The tables that follow show RBSH Group's exposure by country of incorporation of the counterparty at 31 December 2012. Countries shown are those where RBSH Group's balance sheet exposure (as defined in this section) to counterparties incorporated in the country exceeded £0.5 billion (approximately €0.6 billion) and the country had an external rating of A+ or below from Standard and Poor's, Moody's or Fitch at 31 December 2012, as well as selected eurozone countries. The exposures are stated before taking into account mitigants, such as collateral (with the exception of reverse repos), insurance or guarantees, which may have been taken to reduce or eliminate exposure to country risk events. Exposures relating to ocean-going vessels are not included due to their multinational nature. For further details of exposures relating to available-for-sale debt securities by country, refer to page 75.

Definitions

Lending - Comprises gross loans and advances to: central and local government (Govt); central banks, including cash balances; other banks and financial institutions (FI), incorporating overdraft and other short-term facilities; corporates, in large part loans and leases; and individuals, comprising mortgages, personal loans and credit card balances. Lending includes risk elements in lending.

Risk elements in lending (REIL) - Comprises impaired loans and accruing past due 90 days or more as to principal or interest. Impaired loans are all loans (including renegotiated) for which an impairment provision has been established. Accruing past due 90 days or more comprise loans past due 90 days where no impairment loss is expected and those awaiting individual assessment. A latent provision is established for the latter.

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

Derivatives (net) - Comprise the mark-to-market (mtm) value of such contracts after the effect of legally enforceable netting agreements but before the effect of collateral. Figures shown include the effect of counterparty netting used within the regulatory capital model.

Repos (net) - Comprises the mtm value of repo and reverse repo contracts after the effect of legally enforceable netting agreements and collateral. Counterparty netting is applied within the regulatory capital model used.

In addition and as a memorandum item, the mtm value of derivatives and repos gross of netting referred to above are disclosed.

Balance sheet - Comprises lending, debt securities, derivatives (net) and repo (net) exposures, as defined above.

Off-balance sheet - Comprises letters of credit, guarantees, other contingent obligations and committed undrawn facilities.

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

The column CDS notional less fair value represents the instantaneous increase in exposure arising from sold positions netted against the decrease arising from bought positions should the CDS contracts be triggered by a credit event and assuming there is a zero recovery rate on the reference exposure. For a sold position, the change in exposure equals the notional less fair value amount and represents the amount RBSH Group would owe to its CDS counterparties. Positive recovery rates would tend to reduce the gross components (increases and decreases) of those numbers.

Government - Comprises central, regional and local government.

Asset quality (AQ) - for the probability of default range relating to each internal asset quality band, refer to page 62.

Eurozone periphery - comprises Ireland, Spain, Italy, Portugal, Greece and Cyprus.

Other eurozone - comprises Austria, Cyprus, Estonia, Finland, Malta, Slovakia and Slovenia. The Netherlands, while being a eurozone country, has been excluded in these country risk tables as RBSH Group is based in the Netherlands.

Country risk continued

Summary tables

2012	Lending: Central and local government €m	Central banks €m	Other banks €m	Other financial institutions €m	Corporate €m	Personal €m	Total lending €m	Debt securities €m	Derivates (gross of collateral) and repos €m	Balance sheet exposures €m	Off-ba
Eurozone											
Spain	-	-	1	-	54	-	55	5,916	-	5,971	
Italy	-	-	-	83	71	-	154	715	723	1,592	
Ireland	-	-	-	-	91	-	91	433	40	564	
Portugal	-	-	-	-	-	-	-	169	134	303	
Cyprus	-	-	-	-	91	-	91	-	-	91	
Greece	-	-	-	-	-	-	-	-	1	1	
Selected eurozone	-	-	1	83	307	-	391	7,233	898	8,522	
Germany	-	-	-	1	167	-	168	2,166	157	2,491	
France	-	-	7	2	117	-	126	1,173	175	1,474	
Belgium	-	-	-	271	7	-	278	1,006	180	1,464	
Luxembourg	-	-	-	6	34	-	40	-	122	162	
Other eurozone	-	-	-	-	-	-	-	687	-	687	
Total eurozone	-	-	8	363	632	-	1,003	12,265	1,532	14,800	
Other countries											
India	-	123	53	59	1,396	87	1,718	1,137	63	2,918	
China	-	224	502	59	700	-	1,485	314	45	1,844	
Romania	-	80	11	2	424	405	922	292	2	1,216	
Republic of Korea	-	27	61	-	352	-	440	303	215	958	
Brazil	-	-	-	-	85	-	85	637	54	776	

Business review Risk and balance sheet management continued

Country risk: Summary tables continued

	Lending										
	Central and local government	Central banks	Other banks	Other financial institutions	Corporate	Personal	Total lending	Debt securities	Derivates (gross of collateral) and repos	Balance sheet exposures	Off-balance sheet
2011	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Eurozone											
Spain	-	4	4	1	813	-	822	7,662	5	8,489	1,576
Italy	-	2	20	99	1,329	-	1,450	1,104	699	3,253	928
Ireland	-	8	16	-	151	-	175	367	57	599	429
Portugal	-	-	8	-	32	-	40	176	74	290	67
Cyprus	-	-	-	17	91	-	108	-	5	113	59
Greece	8	7	-	-	457	-	472	373	1	846	24
Selected eurozone	8	21	48	117	2,873	-	3,067	9,682	841	13,590	3,083
Germany	-	42	12	17	748	85	904	5,675	599	7,178	3,188
France	-	-	91	35	923	-	1,049	2,599	301	3,949	2,110
Belgium	-	10	11	391	337	-	749	879	196	1,824	766
Luxembourg	-	-	-	75	314	-	389	(47)	1,537	1,879	324
Other eurozone	-	-	17	5	184	-	206	722	-	-	344
Total eurozone	8	73	179	640	5,379	85	6,364	19,510	3,499	29,373	9,815
Other countries											
India	-	329	533	42	3,076	132	4,112	1,732	231	6,075	867
China	11	213	1,470	19	763	5	2,481	654	100	3,235	1,626
Romania	79	173	36	10	494	469	1,261	240	7	1,508	190
Republic of Korea	-	6	764	2	685	-	1,457	711	286	2,454	595
Brazil	-	-	-	-	222	-	222	826	6	1,054	13

Country risk: Summary tables continued

Key points

- Reported exposures are affected by currency movements. Over the year, the euro appreciated 1.8% against the US dollar and depreciated 2.5% against the British pound.

- Balance sheet and off-balance sheet exposure to nearly all countries shown in the table declined significantly over 2012, reflecting the Transfers, in particular the Dutch Scheme, refer to page 9 for details. In addition, RBSH Group maintained a cautious stance and many bank clients reduced debt levels. The reductions were seen in all broad product categories and in all client groups. Most of RBSH Group's country risk exposure was in International Banking (primarily lending and off-balance sheet exposure to corporates), Group Treasury (largely AFS debt securities and liquidity with central banks), and Markets (mostly derivatives and repos with financial institutions).

- Total eurozone (excluding the Netherlands) - Balance sheet exposure declined by €14.6 billion or 50% during 2012 to €14.8 billion, with the largest reductions seen in Germany, Spain, France, Luxembourg, Italy and Greece. This reflected the Transfers, sales of Spanish, Italian and Greek AFS debt securities, write-offs, active exposure management and debt reduction efforts by bank clients.

- Eurozone periphery - Balance sheet exposure decreased to a combined €8.5 billion, a reduction of €5.1 billion or 37%, caused in part by reductions in AFS debt securities in Spain, Italy and Greece. Most of the Group's exposure arises from the activities of Group Treasury, Markets and International Banking. Group Treasury has a portfolio of AFS mortgage-backed Spanish bank and other financial institution bonds.

Markets has a derivatives portfolio in Italy and Portugal. International Banking provides trade finance facilities to clients across Europe, including the eurozone periphery.

- China - Lending exposure and off-balance sheet exposure to banks decreased by €1.0 billion and €1.2 billion, respectively, largely as a result of a slowdown in economic growth, changes in local regulations and risk/return considerations.

CDS protection bought and sold:

- RBSH Group uses CDS contracts to service customer activity as well as manage counterparty and country exposure. During 2012, eurozone gross notional CDS contracts, bought and sold, decreased, caused by the Transfers and by efforts to reduce counterparty credit exposures and risk-weighted assets mainly through derivative compression trades. The fair value of bought and sold CDS contracts also decreased due to the reduction in gross notional CDS positions and a narrowing of CDS spreads over the year for a number of eurozone countries, including Portugal and Ireland. All in all, net bought CDS protection referencing entities in eurozone countries taken by RBSH Group, in terms of CDS notional less fair value, decreased to €0.2 billion, from €0.5 billion at 31 December 2011.

Business review Risk and balance sheet management continued

Country risk continued
Eurozone

						HFT debt securities					CDS by refere		
	Lending	REIL	Provisions	AFS and LAR debt securities	AFS reserves	Long	Short	Total debt securities	Derivatives (gross of collateral) and repos	Balance sheet exposures	Bought Notional	Fair value	No
31 December 2012	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	
Central and local government	-	-	-	4,530	(314)	-	-	4,530	-	4,530	194	21	
Central banks	-	-	-	-	-	-	-	-	-	-	-	-	
Other banks	8	-	-	4,733	(849)	-	-	4,733	1,228	5,969	62	6	
Other financial institutions	363	15	-	2,760	(672)	-	-	2,760	221	3,344	429	2	
Corporate	632	36	15	242	(1)	-	-	242	83	957	41	-	
Personal	-	4	25	-	-	-	-	-	-	-	-	-	
	1,003	55	40	12,265	(1,836)	-	-	12,265	1,532	14,800	726	29	
31 December 2011													
Central and local government	8	-	-	9,416	(680)	-	-	9,416	-	9,424	145	20	
Central banks	73	-	-	-	-	-	-	-	346	419	-	-	
Other banks	179	-	-	7,223	(1,181)	17	4	7,236	690	8,105	111	17	
Other financial institutions	640	-	-	2,609	(826)	6	55	2,560	2,242	5,442	305	12	
Corporate	5,379	618	528	298	(5)	-	-	298	221	5,898	544	18	
Personal	85	74	55	-	-	-	-	-	-	85	-	-	
	6,364	692	583	19,546	(2,692)	23	59	19,510	3,499	29,373	1,105	67	

CDS bought protection: counterparty analysis by internal grading scale

	AQ1		AQ2 - AQ3		AQ4 - AQ9		AQ10		Total	
	Notional	Fair value	Notional	Fair value	Notional	Fair value	Notional	Fair value	Notional	Fair value
31 December 2012	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Banks	-	-	-	-	64	7	-	-	64	7
Other financial institutions	267	22	197	-	197	-	-	-	662	22
	267	22	197	-	261	7	-	-	726	29
31 December 2011										
Banks	74	5	-	-	63	12	-	-	137	17
Other financial institutions	775	49	193	1	-	-	-	-	968	50
	849	54	193	1	63	12	-	-	1,105	67

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Country risk: Eurozone continued

Key points

- During 2012, lending, derivatives and off-balance sheet exposures to eurozone countries were reduced by €5.4 billion, €2.0 billion and €8.1 billion, respectively, largely as a result of the Transfers.
- Debt securities exposure to eurozone countries decreased by €7.3 billion, largely as a result of sales and maturities of AFS debt securities in Germany, Spain and France.

Eurozone periphery

- Spain

Total exposure at 31 December 2012 was €6.1 billion, a decrease by €4.0 billion over the year.

Government and central bank – RBSH Group had AFS debt securities exposure of less than €0.1 billion to the government.

Financial institutions – The largest exposure was AFS debt securities (mainly covered bonds) of €5.9 billion at 31 December 2012, which decreased by €1.8 billion during 2012, largely as a result of sales in the first half of the year. The portfolio continued to perform satisfactorily.

Corporates – Lending exposure decreased by €0.8 billion and off-balance sheet exposure by €1.4 billion largely due to the Transfers. The remaining exposure is less than €0.1 billion.

- Italy

Total exposure at 31 December 2012 was €1.7 billion, a decrease by €2.5 billion over the year.

Government and central bank – Exposure to the government consisted of €0.5 billion of AFS debt securities at 31 December 2012, a reduction by €0.3 billion over the year.

Financial institutions – Total exposure was €1.0 billion, mostly collateralised derivatives exposure to large Italian banks.

Corporates – Lending exposure decreased by €1.3 billion and off-balance sheet exposure by €0.8 billion, due partly to exposure to industrials running off and partly also to the Transfers. The remaining exposure is less than €0.2 billion.

- Ireland

Total exposure at 31 December 2012 was €0.6 billion, a decrease by €0.4 billion over the year.

Government and central bank – Exposure consisted of AFS debt securities of less than €0.2 billion, slightly up due to higher bond prices.

Financial institutions – Exposure was approximately €0.3 billion, mostly AFS bank bonds.

Corporates – Total exposure at 31 December 2012 was less than €0.2 billion, a reduction by €0.4 billion over the year due largely to the Transfers.

- Portugal

Total exposure at 31 December 2012 was €0.3 billion, a decrease of €0.1 billion over the year.

Government and central bank – Exposure consisted of AFS debt securities of less than €0.1 billion, slightly up during the year due to an increase in bond prices.

Financial institutions – Exposure was €0.2 billion, comprising collateralised derivatives and AFS debt securities

Corporates – Lending and off-balance sheet exposure of approximately €0.1 billion fell to zero due to the Transfers. The remaining exposure consists of some very small collateralised derivatives exposure.

- Cyprus

Total exposure at 31 December 2012 was €0.1 billion and comprised lending and off-balance sheet exposure to corporates in the airline, oil & gas and retail sectors.

- Greece

Total exposure fell by €0.9 billion during 2012 to virtually zero mostly due to the Transfers and sales of AFS debt securities.

Market risk

Market risk

Introduction

Market risk arises from fluctuations in interest rates, foreign currency, credit spreads, equity prices, commodity prices and risk related factors such as market volatilities. RBSH Group manages market risk centrally within its trading and non-trading portfolios through a comprehensive market risk management framework. This control framework includes qualitative and quantitative guidance in the form of comprehensive policy statements, dealing authorities, limits based on, but not limited to, value-at-risk (VaR), stressed VaR (SVaR), stress testing and sensitivity analyses.

RBSG Group provides services to RBSH Group to enable appropriate market risk management within RBSH Group.

Governance

Business structure

The primary focus of RBSH Group's trading activities is to provide an extensive range of debt and equity financing, risk management and investment services to its customers, including major corporations and financial institutions around the world. RBSH Group undertakes these activities organised within the principal business lines: money markets, rates flow trading, currencies and commodities, equities, credit markets and portfolio management and origination.

Financial instruments held in RBSH Group's trading portfolios include, but are not limited to: debt securities, loans, deposits, equities, securities sale; and repurchase agreements and derivative financial instruments.

RBSH Group undertakes transactions in financial instruments that are traded or cleared on an exchange, including interest rate swaps, futures and options. Holders of exchange traded instruments provide margin on a daily basis with cash or other security at the exchange.

RBSH Group also undertakes transactions in financial instruments that are traded over-the-counter (OTC), rather than on a recognised exchange. These instruments range from commoditised transactions in derivative markets, to trades where the specific terms are tailored to meet customer requirements.

In 2011, RBSG Group announced plans to transfer a substantial part of its business from RBSH Group to RBS plc in an effort to simplify the structure and reduce risk. During 2012 a substantial part of the business was transferred to RBS plc, as a result of which the range of products in which RBSH Group is active has significantly reduced. A key element of the transfer was the Financial Services Authority (FSA) approval of the Netherlands trading branch location into the scope of RBSG Group's regulatory models.

Organisation structure

Independent oversight and support is provided to the business by the RBSG Global Head of Market & Insurance Risk, assisted by the RBSG Group and Market Risk teams. The head of each business assisted by the business risk management team, is accountable for all market risks associated with its activities.

The RBSG Global Market Risk Committee reviews and makes recommendations concerning the market risk profile across RBSH Group, including risk appetite, risk policy, models, methodology and market risk development issues. The Committee meets monthly and is chaired by the RBSG Global Head of Market & Insurance Risk. Attendees include respective divisional Risk Managers and RBSG Group Market Risk.

Regulatory Risk

Trading activities will indirectly be impacted by regulatory proposals that will change market participants' behaviours. These are discussed in more detail in the Regulatory risk section (refer to page 94). Developments specific to market risk include the Fundamental Review of the Trading Book (FRTB) and the Fundamental Review of the Securitisation Treatments. The FRTB remains at a conceptual stage and there is currently insufficient practical detail available to provide a meaningful assessment of what may eventually be implemented. The Basel Committee's review of the treatment of securitisation positions is further advanced and RBSH Group is currently reviewing how it can participate to assess the impact on trading book activities.

Risk management

Key principles

RBSG Group's qualitative market risk appetite is set out in policy statements, which outline the governance, responsibilities and requirements surrounding the identification, measurement, analysis, management and communication of market risk arising from the trading and non-trading investment activities of RBSG Group. All teams involved in the management and control of market risk are required to fully comply with the policy statements to ensure RBSG Group is not exposed to market risk beyond the qualitative and quantitative risk appetite. The control framework covers the following principles:

- Clearly defined responsibilities and authorities for the primary groups involved in market risk management in RBSG Group;
- An independent market risk management process;
- Daily monitoring, analysis and reporting of market risk exposures against market risk limits;
- Clearly defined limit structure and escalation process in the event of a market risk limit excess;
- A market risk measurement methodology that captures correlation effects and allows aggregation of market risk across risk types, markets and business lines;
- Use of 'Value-at-Risk' (VaR) as a measure of the one-day and SVaR as a measure of the ten-day market risk exposure of all trading positions;
- Use of non-VaR based limits and other controls;
- Use of stress testing and scenario analysis to support the market risk measurement and risk management process by assessing how portfolios and global business lines perform under extreme market conditions;

Market risk: Risk management continued

- Use of backtesting as a diagnostic tool to assess the accuracy of the VaR model and other risk management techniques;

- Adherence to the risks not in VaR (RNIV) framework to identify, quantify and capitalise risks not captured within the VaR model;

- A new product approval process that requires market risk teams to assess and quantify market risk associated with proposed new products.

Risk appetite

The RBSG Group Executive Risk Forum (ERF) approves quantitative market risk appetite for trading and non-trading activities. The RBSG Global Head of Market & Insurance Risk, under delegated authority from the ERF, sets and populates a limit framework, which is cascaded down through legal entity, division, business and desk level market risk limits.

At RBSH Group level, the risk appetite is expressed in the form of a combination of VaR and sensitivity limits and stress testing limits.

A daily report summarises RBSG Group's market risk exposures. This daily report is sent to the RBSG Group Head of Restructuring & Risk, RBSG Group Global Head of Market & Insurance Risk, business RBSG Group Chief Risk Officers and appropriate business Market Risk Managers. In addition a daily report summarising RBSH Group's market risk exposures against the agreed limits is produced and sent to the RBSH Group Head of Market Risk.

Legal entities, divisions, and lower levels in the business have an appropriate market risk framework of controls and limits in place to cover all material market risk exposures. The specific market risk metrics that are appropriate for controlling the positions of a desk will be more granular than the RBSG Group level limit and tailored to the particular business.

The majority of RBSH Group's market risk exposure is in the Markets and Non-Core divisions and Group Treasury. RBSH Group is also exposed to market risk through interest rate risk and foreign exchange risk on its non-trading activities in the retail and commercial businesses. These aspects are discussed in more detail in Balance sheet management – Non-traded interest rate risk on page 48 and structural foreign currency exposures on page 49.

In 2012, a market risk economic capital model was developed. It is planned to use this model for performance measurement within Markets and to assess the trading book risks of RBSG Group from a consolidated economic perspective to a one year horizon. The results of the model will be consolidated with other risk types and reported during 2013.

Market risk exposures in RBSH Group, in common with those in other legal entities within RBSG Group, will contribute to the market risk economic capital measure.

Risk models

Risk models are developed both within business units and by Group functions. Risk models are also subject to independent review and sign-off to the same standard as pricing models. Meetings are held with the DNB as required to discuss the traded market risk, including changes in models, management, back-testing results, risks not included in the VaR framework and other model performance statistics.

VaR - is a technique that produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence level. For internal risk management purposes, RBSG Group’s VaR assumes a time horizon of one trading day and a confidence level of 99%. RBSG Group's VaR model is based on a historical simulation model, utilising data from the previous two years.

At RBSH Group level a different VaR model is employed. It remains based on a historical simulation model and assumes a time horizon of one trading day and a confidence level of 99%. However, it uses 401 observations of historic market data exponentially weighted with a weighted average history of six months. The VaR model has also been approved by the DNB to calculate regulatory capital for the trading book via a scaling approach of 10 days. The approval covers general market risk in interest rate, currency, equity and commodity products and specific risk in interest rate and equity products.

The VaR model is an important market risk measurement and control tool. It is used for determining a significant component of the market risk capital, it is regularly assessed. The main approach employed is the technique known as back-testing which counts the number of days when a loss exceeds the corresponding daily VaR estimate, measured at a 99% confidence level. The VaR model is categorised as green, amber or red. A green model is consistent with a good working model and is achieved for models that have four or less back-testing exceptions in a 12 month period. For RBSH Group’s trading book, a green model status was maintained throughout 2012.

Market risk: Risk management continued
RBSH Group's VaR should be interpreted in light of the limitations of the methodology used, as follows:

- Historical simulation VaR may not provide the best estimate of future market movements. It can only provide a forecast of portfolio losses based on events that occurred in the historical time series used. Therefore, events that are more severe than those in the historical data series are not represented.

- The use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile.

- The use of a one-day time horizon will not fully capture the profit and loss implications of positions that cannot be liquidated or hedged within one day.

- RBSH Group computes the VaR of trading portfolios at the close of business. Positions may change substantially during the course of the trading day and, if so, intra-day profit and losses will be incurred.

These limitations mean that RBSH Group cannot guarantee that losses will not exceed the VaR. During 2012, an improved methodology was implemented for interest rates, to more realistically represent the distribution of rate changes. The enhanced model introduces a level-dependent scaling methodology for interest rates which removes the overestimation of rate fluctuations in regimes of declining rates and leads to a swifter adaptation to changing circumstances in times of increasing rates.

SVaR - is applied to the trading portfolio, is one of the components of regulatory capital and utilises data from a specific one year period of stress. As with VaR, the technique produces estimates of the potential change in the market value of a portfolio over a specified time horizon at given confidence level. For the purposes of calculating regulatory SVaR, a time horizon of ten 10 trading days is assumed and a confidence level of 99%.

In December 2012, the FSA confirmed the European Banking Authority guidelines relating to SVaR. The FSA now requires the use of ‘Dynamic’ SVaR, where the worst one year period of stress is determined on a daily basis. This has also been implemented for RBSH Group, with the approval of the DNB, to keep the process aligned with RBSG Group.

Risks not in VaR (RNIV) - The RNIV framework has been developed to quantify those market risks not adequately captured by VaR and SVaR methodologies. The RNIV approach is used for market risks that fall within the scope of VaR, but which are insufficiently captured by the model methodology, for example due to the lack of sufficient historical data. These risks are therefore assessed outside the VaR model.

RBSG Group adopts two approaches to the quantification of risks not in VaR (RNIVs):

- Some RNIVs are quantified using a standalone VaR approach. For these RNIVs, two values are calculated: (i) the ‘VaR RNIV’; and (ii) the ‘SVaR RNIV’.

- Some RNIVs are quantified using a stress scenario approach. For these RNIVs, an assessment of ten-day extreme, but plausible, market moves is used in combination with position sensitivities to give a stress-type loss number – the stressed RNIV value.

For each legal entity covered by the FSA VaR model waiver, all RNIVs are aggregated to obtain the following three measures: (i) Total VaR RNIV; (ii) Total SVaR RNIV; and (iii) Total stressed RNIV. A similar process is followed for the Market Risk in RBSH Group.

In each case, no allowance is made for potential diversification in respect of material RNIVs.

Incremental risk charge (IRC) - The IRC model aims to quantify the impact of defaults and rating changes on the market value of bonds, credit derivatives, and other related positions held in the trading book. It is calculated over a one year horizon to a 99.9% confidence level, and therefore represents a 1-in-1,000 loss over the following year. The modelling framework differentiates between the liquidity of different underlying instruments, with a minimum liquidity horizon of three months. It also captures basis risks between different products referencing the same underlying credit (e.g. bonds and CDS) and between similar products with different contractual terms (e.g. CDS in different currencies). The portfolio impact of correlated defaults and rating changes is assessed with reference to the resulting market value change of positions, which is determined using stressed recovery rates and modelled credit spread changes. The average liquidity horizon at the year end was 3.5 months.

The IRC model has been further enhanced during 2012 following feedback from the DNB. A separate transition matrix for sovereign exposures was introduced in the IRC model together with a distinct treatment for Agency ABS and renewed parameters for Corporates. Additionally, the calculations for own-debt have been brought into line with European Banking Authority (EBA) guidelines.

All price risk (APR) - The APR model is applied to the corporate credit correlation trading portfolio, subject to certain eligibility constraints (principally that the underlying names are liquid corporate CDS positions). The measure is calibrated to a 99.9% confidence level over a one year time horizon. All material price risks, including defaults and credit rating changes, are within the scope of the model. Of these, the most significant are credit spread risk, credit correlation risk, index basis risk, default risk, and recovery rate risk. In addition, losses due to both hedging costs and hedge slippage are modelled. The overall APR capital charge is floored at 8% of the corresponding standard rules charge for the same portfolio. The average liquidity horizon at the year end was 12 months. During 2012 there was no APR charge for RBSH Group.

Model validation – A model assessment is performed before a new or changed model element is implemented, and before a change is made to a market data mapping. Depending on the results, it may be necessary to notify the DNB before implementation. The form of internal validation depends on the type of model and the materiality of the change.

Business review Risk and balance sheet management continued

Market risk: Risk management continued

In the case of VaR models, the following steps are considered. In some cases, for example a minor change to a market data mapping, it will not be necessary to perform all of the steps. However, in all cases there will be an independent review and validation.

- Perform accuracy testing of the valuation methods used within VaR on appropriately chosen test portfolios. Ensure that tests capture the effect of using external data proxies where these are used.

- Back-test the approach using the relevant portfolio.

- Back-test the approach using hypothetical portfolio(s) where this is helpful for isolating the performance of specific areas of the model.

- Identify all risks not adequately captured in VaR, and ensure that such risks are captured via the risks not in VaR process.

- Identify any model weaknesses or scope limitations, their effect and how they have been addressed.

- Identify ongoing model testing designed to give early warning of market or portfolio weakness becoming significant.

- Perform impact assessment. Estimate the impact on total 1-day and ten-day 99% VaR at the total legal entity level and the major business level, and individual risk factor level 1-day and 10-day 99% VaR at the total legal entity level.

Additionally, RBSG Group Risk Analytics (GRA) assesses the appropriateness of all new or amended models prior to their introduction. Existing approved models are re-assessed on a periodic basis to ensure they remain fit-for-purpose, for example following significant market developments or portfolio changes. The models required to be reviewed by GRA (in relation to market risk) include VaR, SVaR, IRC, APR and economic capital. The independent validation review process will consider some or all of the following areas as appropriate:

- Test and challenge the logical and conceptual soundness of the methodology;

- The assumptions underlying the model will be tested, where feasible against actual behaviour. The validation report will judge the reasonableness and stability of the assumptions and specify which assumptions (if any) should be routinely monitored in production;

- Compare model results with independent model replication;

- Compare outcome with results from alternative methods;

- Test parameter selection and calibration;

- Ensure that model outputs are sufficiently conservative in areas where there is significant model uncertainty;

- Confirm applicability of tests for accuracy, and stability; recalculate; and ensure that results are robust; and
- Ensure appropriate factor sensitivity analysis has been performed and documented.

Stress testing
RBSH Group undertakes daily stress testing to identify the potential losses in excess of VaR. Stress testing is used to calculate a range of trading book exposures which result from severe and extreme market events. Stress testing measures the impact of exceptional changes in market rates and prices on the fair value of RBSH Group's trading and available-for-sale portfolios. Additionally, RBSH Group calculates sensitivity analysis, historical stress tests and bottom-up stress testing.

Sensitivity analysis measures sensitivity of the current portfolio of positions sensitivity to defined market risk factor movements. These stresses are of a smaller magnitude compared to historical or bottom-up stress testing and are subject to the RBSG Group Market Risk limit framework.

Historical stress tests calculate the changes in the portfolio valuations that would be generated if the extreme market movements that occurred during significant historical market events were repeated. Historical stress tests also form part of the Group Market Risk limit framework.

Bottom-up stress testing requires analysis of the market risk exposures by risk factors and different liquidity horizons, to identify the key risks. Stresses for these risks are then designed following consultation with risk managers, economists and front office. The tests may be based on an economic scenario that is translated into risk factor shocks by an economist or by risk managers and front office as a means of assessing the vulnerabilities of their book.

The RBSG Global Market Risk Stress Testing Committee reviews and discusses all matters relating to Market Risk Stress Testing.

Stress test exposures are discussed with senior management and relevant information is reported to the RBSH Group Risk and Control Committee (RCC), ERF, RBSG Group Board and the RBSH Group Managing Board. Breaches in RBSH Group's Market Risk stress testing limits are monitored and reported.

Reverse stress testing is designed to assess the plausibility of scenarios derived by stressing market risk factors until the loss reaches a given threshold. Market Risk contributes to the firm wide, cross risk, reverse stress tests.

In addition to VaR and stress testing, RBSH Group calculates a wide range of sensitivity and position risk measures, for example interest rate ladders or option revaluation matrices. These measures provide valuable additional controls, often at individual desk or strategy level.

Market risk: Risk management continued

Pricing models

Pricing models are developed and owned by the front office. Where pricing models are used as the basis of books and records valuations, they are subject to oversight and approval by asset level modelled product review committees (ALMPRCs).

These committees prioritise models for independent validation by RBSG Group Risk Analytics (GRA) taking into consideration both the materiality of risk booked against the model and an assessment of the degree of model risk (i.e. valuation uncertainty arising from choice of modelling assumptions). GRA review aims to quantify model risk by comparing model outputs against those of alternative independently developed models, the results of which are used by Market Risk to inform risk limits and by Finance to inform model reserves.

Marking-to-market

To ensure that the risks associated with trading activity are reflected in the financial and management statements, assets and liabilities in the trading book are measured at their fair value. Any profits or losses on the revaluation of positions are recognised in the income statement on a daily basis.

The fair value is the amount at which the instrument could be exchanged in a current transaction between willing parties. The fair values are determined following IAS 39 'Financial Instruments: Recognition and Measurement' guidance, which requires banks to use quoted market prices or valuation techniques (models) that make the maximum use of observable inputs.

When marking-to-market using a model, the valuation methodologies must be approved by all stakeholders (trading, finance, market risk, model development and model review) prior to the use for profit and loss and risk management purposes.

Traders are responsible for marking-to-market their trading book positions on a daily basis. Traders can either:

- directly mark a position with a price (e.g. spot foreign exchange); or
- indirectly mark a position through the marking of inputs to an approved model, which will in turn generate a price.

Independent price verification

Independent price verification is a key additional control over front office marking of positions.

Key elements of the independent price verification framework include:

Appropriate financial controls - business unit controllers are responsible for ensuring that independent price verification processes are in place covering all trading book positions held by their business. The independent pricing verification policy requires that daily independent price verification is performed for positions where prices/model inputs are readily available on a daily basis. For positions where prices/model inputs are available on a less regular basis, verification may occur on a frequency that is less than daily. Where practical, verification is performed to a frequency that matches the availability of this independent price information.

Compliance statements - business unit control is required to prepare and maintain compliance statements that benchmark price verification procedures against the independent pricing policy. Each compliance statement requires review and sign-off from the relevant financial controller, market risk manager and front office management every six months at least.

For more information on independent price verification, refer to page 142.

Business review Risk and balance sheet management continued

Market risk analyses
Trading VaR

The table below analyses the VaR for RBSH Group's trading portfolios segregated by type of market risk exposure.

	2012				2011			
	Average	Period end	Maximum	Minimum	Average	Period end	Maximum	Minimum
Trading VaR summary	€m	€m	€m	€m	€m	€m	€m	€m
Interest rate	3.0	2.0	7.4	1.8	4.5	4.0	9.6	3.0
Credit spread	1.4	0.8	3.9	0.8	2.4	1.7	4.3	1.1
Currency	1.7	1.3	11.3	0.6	3.1	1.4	15.3	1.1
Equity	2.1	0.7	9.7	0.5	6.5	2.5	15.8	1.8
Commodity	0.9	0.6	3.1	0.4	0.8	1.1	6.7	-
Diversification (1)		(2.8)				(6.2)		
	4.4	2.6	11.3	2.1	8.5	4.5	18.3	4.0

	2010			
	Average	Period end	Maximum	Minimum
	€m	€m	€m	€m
Interest rate	5.6	4.1	10.1	2.8
Credit spread	6.3	4.0	9.6	1.7
Currency	1.6	2.0	4.7	0.6
Equity	7.6	7.0	14.8	2.0
Commodity	0.8	1.1	4.1	0.1
Diversification (1)	-	(8.7)	-	-
	11.5	9.5	19.0	3.4

Note:
(1) RBSH Group benefits from diversification, which reflects the risk reduction achieved by allocating investments across various financial instrument types, industry counterparties, currencies and regions. The extent of diversification benefit depends on the correlation between the assets and risk factors in the portfolio at a particular time.

Key points
- The average total VaR utilisation fell in 2012 compared with 2011 largely as a result of a reduction in trading book exposure due to transfers of businesses to RBSG Group.

- The average total VaR utilisation fell in 2011 compared with 2010 largely as a result of a reduction in trading book exposure due to transfers of businesses to RBS plc and reduced market volatility experienced throughout the period.

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Other risks

Other risks

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It is an integral and unavoidable part of RBSH Group's business as it is inherent in the processes it operates to provide services to customers and meet strategic objectives.

Operational risk management

The objective of operational risk management is not to remove operational risk altogether, but to manage it to an acceptable level, taking into account the cost of minimising the risk against the resultant reduction in exposure. Strategies to manage operational risk include avoidance, transfer, acceptance and mitigation by controls.

In 2012, RBSH Group continued to make good progress in enhancing its operational risk framework and risk management capabilities. Details of developments undertaken and planned are set out below along with the key processes through which RBSH Group manages operational risk.

In 2013, through fully embedding the enhanced operational risk framework and tools and improving framework linkages, operational risk will be managed on a more forward-looking basis.

Governance, structure and risk appetite

Governance and structure

RBSG Group Operational Risk is an independent function reporting to the Head of Restructuring & Risk. It is responsible for the design and maintenance of the operational risk policy standards. The standards, which are incorporated in RBSG Group Policy Framework (GPF), provide the direction for delivering effective operational risk management and are designed to allow the consistent identification, assessment, management, monitoring and reporting of operational risk across RBSG Group.

The RBSH Group Risk and Control Committee acts upon all operational risk matters and reviews and monitors the operational risk profile across the RBSH Group, in line with risk appetite. It oversees, manages and monitors operational risk strategies and frameworks, and reviews and approves operational risk policy. It escalates and reports necessary items to the Managing Board.

Operational risk appetite, policy and frameworks are presented regularly at the Risk and Control Committee to satisfy oversight responsibilities and, as appropriate, other senior committees.

Risk appetite

RBSH Group's operational risk appetite statement is agreed by the RBSH Managing and Supervisory Board. It comprises a number of specific measures of risk.

To confirm that RBSH Group operates within the set risk appetite, the high-level statement is supplemented by specific tolerances for different types of operational risk. The GPF sets out how to manage risk within acceptable limits, which in turn enables RBSH Group to operate within the overall risk appetite and the specific tolerances.

Operational risk cycle and key management tools

The operational risk cycle comprises four stages:

- identification of risks;
- assessment or measurement of the scale of risks;
- management or control of risks to prevent their recurrence or minimise the potential impact; and
- monitoring and reporting of risks.

Although the operational risk tools encompass all stages of the risk cycle, they can be broadly categorised as follows:

Identification and assessment
Risk and control assessments
Risk and control assessments are used to identify and assess material operational risks and key controls across all business areas. To provide a consistent categorisation of risks and controls across RBSH Group and to support identification of risk concentrations, all risks and controls are mapped to RBSH Group-wide risk taxonomy and newly developed control catalogue.

The process is designed to confirm that risks are effectively managed in line with stated risk appetite, prioritised and documented. Controls are tested frequently to verify and validate that they remain fit for purpose and operate effectively.

Risk assessments are often conducted in a workshop environment, bringing together subject matter experts and key stakeholders from across the division and key functions. This approach has led to a more complete view of the risk profile and more informed decisions.

New product risk assessment process
RBSH Group's new product risk assessment process is designed to identify, assess and approve the risks associated with new products prior to launch.

Several process enhancements were made during 2012, which strengthened the interaction between business, risk and specialist areas.

Management, monitoring and reporting
Issues management
The objective of the operational risk issues management framework is the adoption of a consistent approach to the identification, capture, classification, monitoring, closure and acceptance of operational risk issues and associated actions across RBSH Group.

This element of the operational risk framework continues to be enhanced in areas such as analysis of common issues on an aggregated basis across RBSH Group to identify emerging trends and improvements to the quality of data captured.

Other risks: Operational risk continued

Event and loss data management

Event and loss data management covers the discovery, escalation, capture, investigation, approval and closure, and reporting and analysis of operational risk events and loss data.

It also provides for the clear, simple, quick and consistent communication of operational risk events that meet defined threshold criteria to those members of RBSH Group's senior management and Executives who need to know of these events.

RBSH Group has continued to focus on the timely, accurate capture of operational risk losses; the use of a single Group-wide repository; and the escalation of material operational risk events. This has resulted in enhanced completeness and accuracy of RBSH Group's internal loss data, and transparency of operational risk events, which allows RBSH Group to manage its operational risk profile more effectively.

The event and loss data process will continue to evolve to keep apace with changing regulatory and industry standards regarding the collection of internal loss data.

Insurance

RBSH Group purchases insurance to provide the business with financial protection against specific losses and to comply with statutory or contractual requirements. Insurance is used to help manage RBSH Group's exposures, providing protection against financial loss once a risk has crystallised.

Monitoring and reporting

Monitoring and reporting forms an integral part of all of RBSH Group's operational risk management processes, which are designed to ensure that risks and issues are identified, escalated and managed on a timely basis. Exposures for each division are reported through monthly risk and control reports, which provide detail on the risk exposures and action plans.

Enhancements made during 2012 include single-source extraction and publication of operational risk data across RBSH Group, such as operational risk events and losses. This has resulted in consistent and higher quality information for the purposes of oversight, challenge and operational risk management.

Control environment certification

Control Environment Certification (CEC) is used by RBSH Group's Managing Board to review and assess its internal control framework. Senior management are required to provide a twice-yearly assessment of the robustness of the Group's internal control environment including:

- compliance with the GPF and key divisional/functional policy standards;
- effectiveness of the risk frameworks, culture and governance structures of each division or function to help ensure RBSH Group operates within risk appetite; and
- reporting on the material risks for the business against appetite.

The CEC outcomes are reported at both the RBSH Group Risk & Control Committee and the RBSH Group Audit Committee.

Three lines of defence
Having a strong three lines of defence model is important in a strong control environment. The RBSG Group Executive Committee approved a refreshed model in February 2012 and work is underway to embed this across the Group. The model's main purpose is to define accountabilities and responsibilities for managing risk across the RBSG Group.

Regulatory risk
Regulatory risk is the risk of material loss or liability, legal or regulatory sanctions, or reputational damage, arising from the failure to comply with (or adequately plan for changes to) relevant official sector policy, laws, regulations, or major industry standards, in any location in which RBSH Group operates. RBSH Group believes that maintaining a strong regulatory risk framework is fundamental to protecting sustainable growth, rebuilding its reputation and maintaining stakeholder confidence.

The regulatory environment remained highly challenging during 2012, as policymakers and regulators continued to strengthen regulation and supervision in response to the events of 2007/2008 and subsequent economic and financial stress.

The regulatory agenda - largely framed by the G20 but with many instances of European Union (EU) and national initiatives - constitutes the most sweeping set of changes seen in many decades. At 31 December 2012, RBSG Group was managing some 105 major regulatory or legislative policy initiatives. During the year as a whole, it had also reviewed over 320 consultations in its core markets. In addition to these changes, many supervisory authorities also continued to intensify their ongoing level of scrutiny and intervention.

These trends have posed multiple challenges for banking groups, including RBSH Group, namely:

- tracking, analysing and engaging with policymakers on proposed changes;
- implementing change programmes to ensure compliance with new requirements;
- revisiting strategy, business and operating models in response to the new environment; and
- driving through cultural and other changes to promote good business practice and to minimise enforcement risks.

Global regulatory developments
The global agenda continues to be guided by the G20, drawing on the original action plan for strengthening financial stability agreed by G20 leaders at the November 2008 Washington summit. Although policy initiation at the G20 level is drawing to an end, a substantial pipeline of policy development remains in train and the Group does not anticipate any easing of this for some time. During 2012, G20 countries continued to implement various elements of this action plan, and further endorsed it at the G20 leaders' summit held in Los Cabos, Mexico in June 2012 and the finance ministers' and central bank governors' meetings, most recently in Mexico City in November 2012.

Business review Risk and balance sheet management continued

Other risks: Regulatory risk continued

Key developments during 2012 included the following:

Basel III

Following publication by the Basel Committee on Banking Supervision in December 2010 of rules for the new Basel III capital and liquidity framework, work during 2012 focused on finalising the remaining elements of policy and preparing for implementation. Highlights were:

- publication of results of the Basel III monitoring exercise as at 30 June 2011 (published April 2012) and as at 31 December 2011 (published September 2012). The latest results (which ignore the transitional provisions which apply) showed good progress, with an average Common Equity Tier 1 ratio of 7.7% across 102 banks with Tier 1 capital above €3 billion. This compares to an effective target of 7%. However, individual bank shortfalls, including surcharges for systemically important banks where applicable, still totalled €374 billion;
- the finalisation of rules for composition of capital disclosure requirements (June 2012);
- proposals for monitoring indicators for intraday liquidity management (July 2012);
- interim rules for the capitalisation of bank exposures to central counterparties (July 2012);
- final rules for the regulatory treatment of valuation adjustments to derivative liabilities (July 2012) and
- final rules amending the liquidity coverage ratio (LCR), including revised definitions of high quality liquid assets and net cash outflows. The LCR will now be phased in from 2015 to 2019 and it was also re-confirmed that a stock of liquid assets would be available for use by banks in stress situations (January 2013).

The Basel Committee also turned its attention increasingly to developments beyond Basel III. In particular, it published an initial consultation paper to launch its fundamental review of the trading book (May 2012). Here, the Committee is seeking to improve the coherence of market risk capital requirements and to enhance the consistency of implementation across jurisdictions and convergence of requirements across the industry.

Systemic financial institutions

With the G20-mandated target of agreeing a framework for dealing with global systemically important financial institutions (G-SIFIs) having been met in 2011, much work in 2012 was at the EU level, with discussions on incorporating a general approach into CRD IV.

Separately, and following consultation, the Basel Committee published a framework to address domestic systemically important banks in November 2012, which followed on from its methodology for identifying global systemically important banks developed in 2011. The framework focuses on the impact that the distress or failure of banks will have on the domestic economy. The correct calibration of linkages between the domestic and international frameworks is now critical.

EU regulatory developments

The EU regulatory agenda in 2012 continued to focus mainly on prudential and market structure measures; retail issues also came under increased focus. Key highlights were as follow:

The Liikanen Review
In November 2011, the EU Commissioner for Internal Market and Services, Michel Barnier, announced the establishment of a High-Level Expert Group to consider structural reform of the EU's banks and in early 2012 it was convened under the chairmanship of Erkki Liikanen, the Governor of the Bank of Finland. The group was mandated to consider measures to improve EU banks' stability and efficiency. In addition to any new measures, it was tasked to look at ongoing structural reforms, including the UK Independent Commission on Banking and the US 'Volcker Rule'.

The Expert Group's proposals in October 2012 contained five recommendations: a ring-fence of trading book activities where they form a significant part of a bank's activity; effective recovery and resolution plans (with authorities empowered to require further structural reform if that improves resolvability); specific 'bail-in' instruments (rather than a general bail-in power applied to existing liabilities); stricter capital treatment of trading book and real estate exposures; and a number of corporate governance, risk management and remuneration proposals.

The Commission is considering the Expert Group's recommendations and has said that it will formally respond by September 2013.

Crisis management and banking union proposals
In June 2012, the EU Commission published proposals for an EU-wide recovery and resolution regime, providing for banks and authorities to maintain plans for each firm, setting out measures to set right or resolve businesses should they face difficulties. Authorities would receive a number of powers to intervene in banks for these purposes, including early intervention powers ahead of problems coming to light, and a minimum set of tools to restructure or wind up a failed firm.

Among the new tools is the power to 'bail in' senior creditors when resolving a firm, to ensure losses are spread among shareholders and creditors, without recourse to tax-payer funding. Bailed-in creditors take a loss and become shareholders in the new entity created.

These proposals are likely to be agreed in 2013, with member states and banks in compliance from 2015; and bail-in provisions from 2018. Notwithstanding these developments, the euro-area crisis continued to develop and in July 2012, the President of the European Council, Herman Van Rompuy, set out a road-map for further euro-area financial integration. This aims to both resolve the current crisis and tackle longstanding structural problems in the single-currency zone. Fundamental to these proposals are banking and fiscal union and further economic integration. The President's banking union proposal comprises: a Single Supervisory Mechanism; and mutualisation of bank losses through common deposit guarantee and resolution funding arrangements. The latter two elements are planned to follow agreement of the recovery and resolution regime in 2013.

Other risks: Regulatory risk continued

In September, the EU Commission published its proposal for a Single Supervisory Mechanism, designating the European Central Bank (ECB) as primary prudential supervisor for all euro-area banks, with opt-ins available for EU member states outside the euro-area. The Council of the EU agreed to these proposals, with the proviso that the ECB would directly supervise only larger banks and those in receipt of state aid, while retaining some oversight of smaller banks that fall under the remit of national supervisors.

The European Parliament is now considering the proposals, with agreement expected in early 2013. The ECB will not acquire full supervisory authority until March 2014 and there is scope to delay this. Operational elements, such as how the ECB will be staffed, how it will interact with national supervisors and how it will implement its new macro-prudential responsibilities, remain to be seen. More detail should emerge during 2013.

Prudential and related reforms

A key focus during 2012 was work on agreeing the EU's Capital Requirements Directive (CRD) following the publication of draft legislative text in 2011 for the CRD IV package to implement Basel III in the EU.

Progress of the legislation was slower than hoped and did not conclude before the Basel III start date of 1 January 2013. Nevertheless, the European Banking Authority did press ahead with proposals for a number of the technical standards mandated by CRD IV, including reporting of own funds, liquidity, leverage and large exposures; gain on sale of associated with future margin income in a securitisation context; credit valuation adjustment; and prudent valuation.

Other prudential initiatives have included, notably, continued work on developing the Solvency II framework for insurers; capital requirements for central counterparties; corporate governance in financial institutions; and supervision of financial conglomerates.

Market and structural reforms

Key developments included:

- European Markets Infrastructure Regulation - the regulation came into force on 16 August 2012. In many areas, the European Securities and Markets Authority (ESMA) is yet to finalise draft technical standards. Full implementation is likely to be in the third quarter of 2013, when the final technical standards are due to be released by the ESMA.

- Markets in Financial Instruments Directive - the European Parliament voted on the proposal in September 2012 but the Council of the EU had not agreed its final position by the end of 2012. The new Irish Presidency of the Council plans to finalise the proposals before the end of its term in June 2013.

- Financial Transaction Tax - the EU Commission has previously published proposals, which would see trades in bonds and shares taxed at 0.1% and complex derivatives taxed at 0.01%. While the original EU-wide proposal was rejected due to opposition from several member states, including the UK, a subset of eleven EU member states has agreed to proceed via the Enhanced Cooperation Mechanism. The Commission set out detailed proposals for this in February 2013.

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Other initiatives - these have included proposals to revise the Data Protection Directive, further changes to the market abuse regime and prospectus requirements, further legislative developments impacting credit rating agencies (CRA III) and changes to depositor and investor protection.

Supervisory developments

Netherlands regulatory developments

In the Netherlands developments during 2012 in relation to financial reforms continued to be extensively determined by global and EU developments mentioned above, with new regulations to implement requirements coming into force. Important regulations and proposals were issued aiming at a sound and controlled financial sector, optimal consumer protection and adequate supervision.

Sound financial markets also require a change in conduct and culture of financial institutions. During 2012, new regulations with regard to remuneration of staff and the suitability of members of supervisory and managing boards were introduced.

In September 2012, the Ministry of Finance endorsed the recommendations of a parliamentary committee (Commissie de Wit) to strengthen the financial system and enhance crisis management. The recommendations also include more stringent requirements of the Dutch Banking Code (related to risk management, and remuneration) and culture change. A Bankers' Oath will be mandatory for all staff in financial institutions as of 1 January 2013.

US regulatory developments

In the US, activity continued to be dominated by rulemaking following the 2010 Dodd-Frank Act.

Key final rules were issued on a range of issues, including prudential standards for systemically important financial institutions, removal of certain references to credit rating agencies, Basel 2.5 market risk standards and final definitions of swap dealers, major swap participants and swaps. Requirements for the registration of entities as swap dealers took effect from 12 October 2012, with registration commencing from 31 December 2012 once firms reach certain activity thresholds.

Proposed rules issued in December 2012 included important changes to the Federal Reserve Board's approach to supervisory and prudential requirements for foreign banking organizations (FBOs). These proposals would require RBSG Group and other FBOs to establish a single US-incorporated intermediate holding company for all the Group's US subsidiaries (although not the US branches of RBS N.V.). Enhanced prudential standards would also be required, including for the US branches.

Other risks: Regulatory risk continued

Other proposals included Basel III capital and leverage standards and disclosures and other rules relating to mortgages. The Volcker Rule, which restricts proprietary trading and investments in private equity/hedge funds, was not finalised by its effective date of 21 July 2012 but in April 2012 the Federal Reserve Board issued an interpretation which provided some guidance to the effect that banks should demonstrate their 'good faith' planning efforts in the two-year conformance period to July 2014.

Regulatory risk management

RBSH Group manages its regulatory risk through a regulatory affairs framework covering different regulatory bodies and central banks, wherever RBSH Group operates. This framework is managed by RBSH Group's Regulatory Affairs function and includes: the tracking and management of regulatory developments and regulatory relationship management together with ownership of the connected regulatory risk policies; assurance and monitoring; and training and awareness.

Recovery and resolution planning

Individual country regulators are developing and implementing their rules according to their own timescales. This emphasises the need for consistency of approach, both by the regulatory bodies and internally within RBSH Group, to ensure effective management of financial stability across jurisdictions, and to avoid duplication and inefficiency for cross-border banks.

Conduct risk

Conduct risk is the risk that the conduct of RBSH Group and its staff towards its customers, or within the markets in which it operates, leads to reputational damage and/or financial loss by breaching regulatory rules or laws, or failing to meet customers' or regulators' expectations of RBSH Group. Activities through which conduct risk may arise include: personal account dealing; privacy and data protection; conflicts of interest; money laundering; and bribery and corruption.

Effective conduct risk management is not only a commercial imperative for RBSH Group; customers, clients and counterparties demand it as a precursor to building trust. It also reflects the changing regulatory environment in the UK, with the establishment of the Financial Services Conduct Business Unit (precursor to the Financial Conduct Authority), and the increasing focus of overseas regulators on conduct risk.

RBSH Group's compliance functions are responsible for monitoring the management of conduct risk, including anti-money laundering (AML); sanctions and terrorist financing; and anti-bribery and corruption. In doing so, they design, implement and maintain an effective management framework to enable consistent identification, assessment, monitoring and reporting of conduct risk.

Policy design and implementation

Placing conduct risk at the centre of RBSG Group's philosophy promotes a customer-oriented culture that informs and challenges business strategy, delivers fair outcomes and promotes behaviours consistent with regulatory and legal standards across its retail and wholesale markets.

RBSG Group has established a defined and measurable appetite for conduct risk to ensure commercial decisions take into account any conduct risk implications. During 2012, the foundations of RBSG Group's conduct risk framework were delivered. Key milestones were:

- Agreeing and establishing the Group's conduct risk policies under four pillars: employee conduct; corporate conduct; market conduct; and conduct towards the Group's customers. Each is designed to provide high-level direction to the Group and is supported by the Group's Code of Conduct;

- Launching a phased roll-out of these policies, in order of materiality and scheduled to complete in June 2013;

- Developing and delivering awareness initiatives and targeted conduct risk training for each policy, aligned to the phased roll-out, to assist businesses and executives in embedding the understanding of conduct risk and provide the necessary clarity for staff on their conduct risk requirements;

- Establishing effective leadership and a supporting governance framework, with the participation of all divisions, to oversee the Group's conduct agenda, notably the new Conduct Risk Committee; and

- Completion by the separate AML Change Programme of its Group-wide gap analysis and benchmarking against enhanced policies, including recording identified issues, establishing a new AML organisational reporting and accountability hierarchy, initiating comprehensive and continuing tailored staff training; and establishing a global AML assurance programme.

Anti Money Laundering
During 2012, RBSH Group continued to enhance its Anti-Money Laundering (AML) Change Programme. Key developments include significant progress made with the delivery of the new cohesive AML target operating model and the management of AML risks.

Training and awareness
Maintaining compliance with existing rules and regulations requires continued investment in professional training, as well as maintaining risk awareness. During 2012, RBSH Group continued to focus on strengthening the capabilities of its compliance functions, at both Group and divisional level. In addition, it facilitated training on conduct risk through Executive education, including master classes and workshops, and computer-based RBSG Group Policy Learning modules. Each module addresses the specific regulatory content of relevant RBSG Group Policy Standards.

A comprehensive and progressive training programme supports the professional development of RBSH Group's compliance teams. All members of these teams are engaged in compliance eLearning, including a mandatory 'essentials' course, and the RBSG Group Risk Academy, through which all staff are required to complete foundation courses in other risk disciplines, such as operational risk, market risk and retail credit risk.

Other risks: Conduct risk continued

Formal training is supplemented by regulatory familiarisation, designed to share knowledge and support both personal development and technical training across RBSH Group's wider risk community.

Assurance and monitoring

Assurance and monitoring activities are essential to ensure that RBSH Group can: demonstrate compliance with existing rules and regulations; assess whether it is managing its conduct risks appropriately; and determine whether key controls are fit for purpose and effective.

During 2012, as well as providing thematic process reviews and assurance over specific compliance topics, RBSH Group Compliance assurance team, working with its divisional counterparts, validated the closure of issues it identified during the 2011 programme of Group-wide assurance reviews, and identified common issues between divisions.

Reputational risk

Reputational risk is the risk of brand damage arising from financial and non-financial events due to a failure to meet stakeholders' expectations of RBSH Group's conduct and performance.

Restoring the reputation of RBSH Group and the wider banking sector is built upon the role of banks as good companies that perform well for their owners, regulators, employees and communities and, above all else, serve their customers well.

RBSH Group has put the focus on serving customers well at the heart of its strategic objectives that, combined with a safe and sound bank, will build a culture and reputation in line with our stakeholder expectations. There are still legacy issues to work through, but dealing with them in an open and direct manner is a necessary part of the ability to move forward.

RBSH Group's reputational risk management framework is aligned with its strategic objectives and its risk appetite. It is designed to embed, at different points of decision-making processes, a series of customer-related and reputational filters and controls that examine products, services and activities through the lenses of sustainability, transparency and fairness.

This approach recognises that reputational risk can arise across a range of actions taken (or, in some cases, not taken) by RBSH Group, as well as its wider conduct, policies and practices. Therefore, it is aligned with the management of a range of risk types that have a high reputational sensitivity.

For example, an Environmental, Social and Ethical (ESE) risk management function assesses the ESE risks associated with business engagements and business divisions, while RBSH Group Policy Framework includes a range of policies relating to conduct and reputational matters.

The RBSG Group Board has ultimate responsibility for managing RBSH Group's reputation, though all parts of RBSH Group have responsibility for any reputational impact arising from their operations.

The RBSG Group Board's oversight of reputational issues is supported by executive risk committees (including the new RBSG Group Conduct Risk Committee) and by RBSG Group Sustainability Committee. Emerging reputational issues are pro-actively identified and assessed by a dedicated working group, and escalated through the appropriate governance channels where necessary.

The Managing Board has ultimate responsibility for managing any impact on the reputation of RBSH Group arising from its operations. The RBSG Group Sustainability Committee (established at the beginning of 2010) sets the overall strategy and approach for the management of Group sustainability. However, all parts of RBSH Group take responsibility for reputation management.

Business risk

Business risk is the risk that RBSH Group suffers losses as a result of adverse variance in its revenues and/or costs relative to its business plan and strategy.

RBSH Group seeks to minimise its exposure to business risk, subject to its wider strategic objectives. Business risk is identified, measured and managed through RBSH Group's planning cycles and performance management processes. Expected profiles for revenues and costs are determined, on a bottom-up basis, through plans reflecting expectations of the external environment and RBSH Group's strategic priorities. These profiles are tested against a range of stress scenarios and factors to identify the key risk drivers behind any potential volatility, along with management actions to address and manage them.

The Managing Board has ultimate responsibility for the impact of any volatility in revenues and costs on RBSH Group's performance.

Pension risk

RBSH Group is exposed to risk from its defined benefit pension schemes to the extent that the assets of the schemes do not fully match the timing and amount of the schemes' liabilities. Pension scheme liabilities vary with changes to long-term interest rates, inflation, pensionable salaries and the longevity of scheme members as well as changes in legislation. Ultimate responsibility for RBSH Group's pension schemes is separate from RBSH Group management. RBSH Group is exposed to the risk that the market value of the schemes' assets, together with future returns and any additional future contributions could be considered insufficient to meet the liabilities as they fall due. In such circumstances, RBSH Group could be obliged, or may choose, to make additional contributions to the schemes.

The pension funds in India are the main source of pension risk. The Trustee or Pension Boards of these schemes are solely responsible for the investment of the schemes' assets which are held separately from the assets of RBSH Group.

Asset protection scheme

Asset protection scheme

Introduction

In 2009, RBS plc entered into an agreement (the Asset Protection Scheme (APS)) with HM Treasury (HMT), acting on behalf of the UK Government, under which it purchased credit protection over a portfolio of specified assets and exposures (covered assets) from HMT. Due to the progress RBS plc has made in obtaining a more conservative, resilient, and sustainable balance sheet, RBS plc agreed with HM Treasury to exit the APS effective 18 October 2012.

Although the APS portfolio of covered assets included assets recorded on RBSH Group's balance sheet, RBSH Group was not entitled to benefit under this contract. Therefore, RBSH Group entered into credit protection agreements in 2009 in the form of a financial guarantee contract and a credit derivative contract with RBS plc (the Contracts) that provide full principal protection over those covered assets attributable to RBSH Group for their remaining life. The Contracts are not impacted by RBS plc's exit from APS and as a result, there has been no change to these contracts for the year ended the 31 December 2012.

With effect from 1 January 2013, the Managing Board of RBS Holdings N.V. has agreed with RBS plc to reduce the number of covered assets included in the Contracts as a result of the progress made with the Transfers to RBS plc during 2011 and 2012 (as discussed on page 9). Unamortised fees relating to the assets previously covered will be reimbursed by RBS plc.

The Contracts

Under the terms of the Contracts, on impairment of a covered asset RBSH Group is entitled to receive from RBS plc the present value of the difference between contractual and expected cash flows from the asset; subsequent reductions in the estimated lost cash flows are paid by the Group to RBS plc and increases paid by RBS plc to RBSH Group.

The credit derivative which protects a portfolio of financial assets, principally derivative financial assets, measured at fair value with changes in fair value taken to profit or loss, meets the definition of a derivative in IAS 39 and is carried at fair value with changes in fair value reflected in profit or loss.

The financial guarantee contract protects a portfolio of assets classified as loans and receivables. It meets the definition of a financial guarantee contract in IAS 39 and was recorded initially at its transaction value. It is being amortised to profit or loss over the expected remaining life of the assets in the portfolio it guarantees.

No adjustments are made to the measurement of the covered assets to reflect the protection provided by the financial guarantee contract and the credit derivative. Impairment provisions on covered assets classified as loans and receivables are assessed and charged in accordance with RBSH Group's accounting policy; covered assets that are held-for-trading, designated at fair value or classified as available-for-sale continue to be measured at fair value with no adjustments to reflect the protection received. There is no change in how gains and losses on the covered assets are recognised in the income statement or in other comprehensive income. As a result RBSH Group's credit quality ratios are unaffected.

At the time an impairment loss is recognised on a covered asset classified as loans and receivables, a reimbursement asset representing the amount receivable from RBS plc is recognized in the balance sheet with a corresponding entry to profit or loss offsetting the impairment charge.

The Contracts covered portfolio for the year ended 31 December 2012 was €2.4 billion (2011 - €10.9 billion), with an average remaining maturity of four years. At 31 December 2012 the carrying value of the prepaid fee for the financial guarantee contract was €145 million (2011 - €323 million). At 31 December 2012 the net carrying value of the credit derivative was €11.7 million (liability), (2011 - €8 million (liability), which consists of the fair value of the credit derivative of €199 million against collateral of €211 million placed by RBS plc (2011 - €213 million against €221 million respectively).

Business review Risk and balance sheet management continued

Asset protection scheme continued

Covered assets

The table below provides a breakdown of assets covered under the Contracts.

2012	Residential mortgages €m	Consumer finance €m	Commercial real estate finance €m	Leveraged finance €m	Project finance €m	Structured finance €m	Loans €m	Bonds €m	Derivatives €m	Total €m
Financial institutions	113	130	-	23	-	291	197	22	477	1,253
Manufacturing	-	-	-	168	-	-	141	20	53	382
Natural resources	-	-	-	-	30	-	24	-	22	76
Property	-	-	46	-	-	-	1	12	66	125
Retail and leisure	-	-	-	-	-	-	4	-	17	21
Services	-	-	-	68	-	-	84	4	46	202
TMT	-	-	-	-	-	-	59	-	3	62
Transport	-	-	-	-	-	-	36	-	227	263
Personal and SME	-	-	-	-	-	-	-	-	-	-
Total	113	130	46	259	30	291	546	58	911	2,384
2011										
Financial institutions	136	151	-	110	-	355	1,293	26	581	2,652
Manufacturing	-	-	-	1,744	-	-	2,154	41	540	4,479
Natural resources	-	-	-	-	75	-	145	-	26	246
Property	-	-	105	-	-	-	116	-	141	362
Retail and leisure	-	-	-	227	-	-	474	-	-	701
Services	-	-	68	110	-	-	120	7	28	333
TMT	-	-	-	299	-	-	616	8	67	990
Transport	-	-	-	10	39	-	308	313	357	1,027
Personal and SME	-	-	36	-	-	-	35	14	8	93
Total	136	151	209	2,500	114	355	5,261	409	1,748	10,883
2010										
Financial institutions	150	198	-	156	-	230	2,123	26	3,705	6,588
Manufacturing	-	-	-	318	-	-	3,890	56	459	4,723
Natural resources	-	-	-	-	58	-	447	-	15	520
Property	-	-	89	-	-	-	132	17	15	253
Retail and leisure	-	-	-	407	6	-	822	-	5	1,240
Services	-	-	77	635	-	-	369	15	181	1,277
TMT	-	-	-	317	-	-	1,327	7	30	1,681
Transport	-	-	-	32	38	-	431	313	214	1,028
Personal and SME	-	-	37	-	-	-	89	14	-	140
Total	150	198	203	1,865	102	230	9,630	448	4,624	17,450

Credit quality of credit risk assets
The table below analyses the credit quality of the credit risk assets by risk bands of covered assets.

Asset quality band	Probability of default range	2012 €m	2011 €m	2010 €m
AQ1	0% - 0.034%	123	702	851
AQ2	0.034% - 0.048%	407	1,303	977
AQ3	0.048% - 0.095%	39	232	1,518
AQ4	0.095% - 0.381%	92	1,247	1,607
AQ5	0.381% - 1.076%	520	2,214	3,058
AQ6	1.076% - 2.153%	37	575	1,064
AQ7	2.153% - 6.089%	298	2,342	1,169
AQ8	6.089% - 17.222%	29	77	236
AQ9	17.222% - 100%	83	165	4,029
AQ10	100%	756	2,026	2,941
Total		2,384	10,883	17,450

Corporate governance

Corporate governance continued

Introduction

RBSH Group continues to maintain high corporate governance standards. This is critical in order to realise its strategic goal of creating sustainable long-term value for all RBSH Group's stakeholders – including its shareholders, clients, employees and society at large.

RBSH Group's operations are guided by its code of conduct.

In order to achieve good corporate governance RBSH Group organises the business in a way that promotes first-class stewardship by the Managing Board and effective supervision by the Supervisory Board. Integrity, transparency and accountability are key elements of RBSH Group's corporate governance, as they are embedded in RBSH Group's business as a whole. These key elements ensure that the controls and oversight necessary for effective risk management, compliance with regulations, and accurate and complete disclosure of information to the market are effective.

Corporate governance in the Netherlands

Dutch Corporate Governance Code

As a result of the delisting in 2008, the Company is no longer required to adhere to Dutch Corporate Governance Code. RBSH Group ensures proper corporate governance by focusing on the Dutch Banking Code (Code Banken) which caters for specific corporate governance rules for banks. However as the Dutch Corporate Governance Code is of great standing within the Netherlands, RBSH Group adheres where possible.

The Dutch Banking Code (Code Banken)

The Code Banken came into force on 1 January 2010 and requires banks to either comply with the Code Banken or explain any deviation from it. The Code Banken is applicable to RBS N.V. as it has a banking license issued under the Dutch Financial Supervision Act. A further explanation on compliance with the Code Banken is provided on page 111 of this report.

Capital Requirement Directive III (CRD III)

CRD III contains certain provisions on capital requirements for trading portfolios and securitisations. It also contains principles on sound compensation policies. Each member state of the European Union has the requirement to implement the directive in their national legislation.

RBSH Group adheres fully to the principles of CRD III that were implemented in the Netherlands.

DNB Principles on Sound Remuneration

The principles of sound compensation policies were implemented by the publication of the Regulation by the Dutch Central Bank on Sound Compensation Policies for Financial Institutions, which came into effect on 1 January 2011. RBSH Group adheres fully to these principles on Sound Remuneration that were implemented in the Netherlands.

Further details of RBSG's remuneration policy can be found in the RBSG Annual Report & Accounts and the Remuneration Report both available on www.rbs.com.

Corporate governance in the United States
As a SEC-registered company, RBSH Group is subject to US securities laws, including the Sarbanes-Oxley Act, as well as certain corporate governance rules in connection with RBSH Group's listing of NYSE Alternext debt.

To meet the requirements of the Sarbanes-Oxley Act, RBSH Group established a Disclosure Committee that formalised the roles, tasks and disciplines that were already in place for ensuring the accuracy and completeness of information disclosed to the market.

RBSH Group's report on internal control over financial reporting under Section 404 of the US Sarbanes-Oxley Act is included on page 114.

Approval of Annual Report
The Managing Board has approved the Annual Report in its meeting on 22 March 2013. The Supervisory Board has approved the Annual Report during its meeting on 27 March 2013. RBSH Group has proposed to its Shareholders that it adopts the 2012 financial statements, as included in this Annual Report, and discharge the Managing Board and Supervisory Board in respect of their management and supervision respectively.

Boards and Committees
RBS Holdings and RBS N.V. are both companies with limited liability incorporated under the laws of the Netherlands. Both companies have a two-tier system of corporate governance; consisting of a Supervisory Board and a Managing Board. The day to day management of the companies vests with the Managing Board. The Supervisory Board provides oversight and advice to the Managing Board.

There is a personal union in place between the Managing Boards of RBS Holdings and RBS N.V. and between the Supervisory Boards of RBS Holdings and RBS N.V. This entails that the members of the Managing Board and Supervisory Board of RBS Holdings and RBS N.V. are the same.

The report of the Supervisory Board
The Supervisory Board supervises the Managing Board, as well as the general affairs of RBS Holdings and the enterprises connected to it. Furthermore, it assists and advises management and supervises the corporate governance structure of RBS Holdings.

In performing their duties, the members of the Supervisory Board are guided by the interests of RBSH Group and the businesses connected to it and shall take into account the relevant interests of RBSH Group's stakeholders. Certain powers vest in the Supervisory Board, including the approval of certain resolutions by the Managing Board. A complete overview of the powers vested with the Supervisory Board can be found in the Rules governing the Supervisory Board's Principles and best Practices, which are published on the RBSH Group's website at www.rbs.nl. These rules are also applicable to the Supervisory Board of RBS N.V. and include the Terms of Reference of the Risk & Audit Committee.

Corporate governance continued

Boards and Committees: The report of the Supervisory Board continued

The Supervisory Board is an independent corporate body. Members of the Supervisory Board are appointed at the General Meeting of Shareholders. For each vacant seat the Supervisory Board nominates one or more candidates. Under the Dutch Corporate Governance Code, which is mandatory for listed companies, all members of the Supervisory Board must be independent with the exception of not more than one person. RBSH Group is not compliant with that standard. RBSH Group has four Supervisory Board members who can not be considered as independent within the scope of the Dutch Corporate Governance Code.

The Supervisory Board confirms that its current composition has the necessary experience, expertise and independence to ensure that its members are able to properly execute their duties. All appointments were made in accordance with the Supervisory Board profile resulting in the current composition of the board. The Supervisory Board is of the opinion that the addition of a female Supervisory Board member would be beneficial to its functioning and would then align with the RBSG Group policy on diversity and inclusion. The Supervisory Board will therefore commit to identifying and nominating a female candidate on the company's Supervisory Board if a vacancy would arise.

Supervisory Board members are appointed for a term of four years and may be re-appointed after that term, with a maximum term of 12 years from the date of their first appointment. In addition, each member is required to resign at the first General Meeting of Shareholders after reaching the age of 70.

Candidates recommended for appointment or re-appointment to the Supervisory Board must meet the criteria of the membership profile, which are set out in the Rules Governing the Supervisory Board's Principles and Best Practices of RBSH Group, which are also applicable to the Supervisory Board of RBS N.V.

Newly appointed Supervisory Board members undertake an induction programme.

The new Supervisory Board members receive relevant documentation necessary for their role in RBSH Group and undertake a series of meetings with the management of RBSH Group to gain insight and understanding of RBSH Group and its enterprises.

In addition, meetings are set up with management of RBSG Group to provide for an introduction to RBSG Group and its businesses. The programme is tailor-made and is adjusted to the specific needs of the new Supervisory Board member.

In case of a (potential) conflict of interest of material significance between a member of the Supervisory Board and RBS Holdings, the Chairman of the Supervisory Board shall be notified. If the Chairman of the Supervisory Board has a (potential) conflict of interest of material significance, the Vice-Chairman is notified. The Supervisory Board member concerned will not take part in the assessment by the Supervisory Board where a conflict of interest exists.

Details of the Supervisory Board's remuneration can be found on page 207.

The Chairman and Vice-Chairman of the Supervisory Board are appointed by the Supervisory Board from among its members. The Supervisory Board also appoints from its own members, the members of the Risk & Audit Committee.

Currently, all members of the Supervisory Board are a member of the Risk & Audit committee.

Composition of the Supervisory Board

The members of the Supervisory Board, and their respective Supervisory Board committee membership, as at 27 March 2013 are as follow:

		Date of first appointment	Date for re-election
Bruce Van Saun (Chairman)	(55, American, m) RA*	1 April 2010	1 April 2014
Henk Rottinghuis	(57, Dutch, m) RA**	1 September 2010	1 September 2014
Christopher Campbell	(54, British, m) RA***	23 June 2011	23 June 2015
Ron Teerlink (Vice-Chairman)	(52, Dutch, m) RA*	1 April 2010	1 April 2014
Sietze Hepkema	(59, Dutch, m) RA**	1 September 2010	1 September 2014

RA member of the Risk & Audit Committee.
* as of 9 April 2010.
** as of 2 November 2010.
*** as of 1 August 2011.
m male

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Corporate governance continued

Boards and Committees: The report of the Supervisory Board continued

Bruce Van Saun - Chairman of the Supervisory Board

Mr. Van Saun was appointed to the Supervisory Board on 1 April 2010. Appointed to the Board of RBSG in October 2009 as Group Finance Director, Mr. Van Saun has extensive leadership experience with 30 years in the financial services industry. From 1997 to 2008 he held a number of senior positions with Bank of New York and later Bank of New York Mellon, most recently as vice chairman and chief financial officer and before that he was responsible for Asset Management and Market Related businesses. Prior to that, he held senior positions with Deutsche Bank, Wasserstein, Perella Group and Kidder Peabody & Co. From late 2008 through joining RBSG Group he worked as an advisor to US private equity firms. He is currently a non-executive director of Direct Line Insurance Group plc, WorldPay (Ship Midco Limited) and Lloyd’s of London. He previously served on several corporate Boards in the US and has been active in numerous community organisations.

Christopher Campbell

Mr. Campbell was appointed as a member of the Supervisory Board on 23 June 2011. Mr. Campbell joined RBSG Group in August 2005 as Deputy General Counsel and Director, Group Legal and became Group General Counsel in May 2010. Prior to joining RBS, Mr. Campbell was a partner for 18 years in Scotland’s largest law firm, Dundas & Wilson, and was Managing Partner from 1996 until he joined RBSG Group in 2005. In his role as Group General Counsel, Mr. Campbell has overall responsibility for advising the RBSG Group Board and Executive Committee and for the provision of legal support to all of RBS’s businesses globally. His responsibilities also include RBSG Group Secretariat and Regulatory Affairs functions.

Ron Teerlink - Vice-Chairman of the Supervisory Board

Mr. Teerlink was appointed to the Supervisory Board on 1 April 2010. In April 2008 Mr. Teerlink joined the RBSG Group as Chief Executive of Business Services, becoming RBSG Group Chief Administrative Officer in February 2009. At the same time he was re-appointed to the Managing Board of ABN AMRO to oversee the integration programme. Mr. Teerlink started his career with ABN Bank in 1986 as an IT/Systems analyst and held various functional positions before becoming Chief Operating Officer of the Wholesale Clients Business in 2002. He was appointed Chief Executive Officer of Group Shared Services in 2004 and joined ABN AMRO's Managing Board in January 2006, where he was responsible for Services and Market Infrastructure. Mr. Teerlink holds a Masters degree in Economics from Amsterdam's Vrije Universiteit.

Henk Rottinghuis

Mr. Rottinghuis was appointed to the Supervisory Board on 1 September 2010. Mr. Rottinghuis has been a Member of the Executive Board of Pon Holdings B.V. since 1999 and was appointed CEO in 2001, a position he held for nearly ten years. Before joining the Board, he worked as the Managing Director of Pon's Automobielhandel, the importer of Volkswagen, Audi and Porsche in The Netherlands and Poland, and was responsible for all import activities in the automotive arm of Pon Holdings. Mr. Rottinghuis started his career in 1982 at the Royal Nedlloyd Group, a shipping and transport group, where he held various management positions for a period of ten years. He holds a Master of Laws from the Rijksuniversiteit Groningen, and has followed an executive programme at Harvard Business School. He holds several Board positions with larger family companies. He is Chairman of the Supervisory Board of Stork Technical Services.

Sietze Hepkema

Mr. Hepkema was appointed as a member of the Supervisory Board on 1 September 2010. Mr Hepkema currently is a member of the Management Board (RvB) of SBM Offshore N.V. He is responsible for compliance, governance, legal and insurance. Until 2012 Mr. Hepkema was a corporate and M&A lawyer at Allen & Overy LLP. He was Senior Partner of the Amsterdam office from 1999 to 2009 and a member of the firm's Board from 2000 to 2010. Before joining Allen & Overy, Mr. Hepkema was Partner at Loeff Claeys Verbeke for 12 years, where he was appointed to the Managing Board in 1989. Between 1981 and 1987 he worked at Graham & James in San Francisco and Singapore. He holds a Master of Laws from the Erasmus University Rotterdam and an LLM from Harvard Law School.

Activities of the Supervisory Board

The Supervisory Board met on sixteen occasions during 2012. The meetings took place in person, via conference call by telephone and on a few occasions the members were also asked to give their approval on a few matters via email procedure.

The assessment of the functioning of the Managing Board members and Supervisory Board, their members and the committee of the Supervisory Board has taken place in the first quarter of 2013.

The Chairman of the Supervisory Board and the Company Secretary prepared the agenda for the meetings of the Supervisory Board in close co-operation with the Chairman of the Managing Board.

The Supervisory Board reviewed and adopted the full year 2011 results at its meeting on 22 March 2012 and reviewed and adopted the half-year financial report 2012 on 30 August 2012. The Board reviewed in these meetings regulatory, control and audit issues, including Sarbanes-Oxley Act 404 compliance.

During the second and third quarter of 2012, the Supervisory Board received regular updates on the proposed transfers of assets and liabilities to RBS plc. During the second quarter, the Dutch scheme, as part of the proposed transfers, was approved. The financial performance of RBSH Group was extensively discussed during a number of Supervisory Board meetings, which were attended by a number of Managing Board members who gave an explanation of the results. Also, relevant members discussed findings of internal and external auditors.

On five occasions in 2012, the meeting of the Supervisory Board was preceded by a meeting of the Risk & Audit Committee, which advised the Supervisory Board, amongst others, on the adoption of the financial results. Comprehensive information provided by the Managing Board and reviewed by the Risk & Audit Committee gave the Supervisory Board a clear picture of RBSH Group's risks, results, capital and liquidity position. The Risk & Audit committee continued to report their deliberations and findings to the Supervisory Board for further discussion and, where appropriate, decision.

Corporate governance continued

Boards and Committees: The report of the Supervisory Board continued

The strategy of RBSH Group was determined in conjunction with the divisional strategy of RBSG Group and was adopted by the Supervisory Board during its meeting on 9 April 2010 and further updated in their meeting of 8 April 2011.

The Shareholder reappointed Deloitte Accountants B.V. as the external auditors of RBS Holdings N.V. for the 2012 financial year.

All members of the Supervisory Board have complied with the requirement to attend meetings on a frequent basis.

Supervisory Board committee

The Supervisory Board has one sub-committee, the Risk & Audit Committee. This Committee is responsible for all matters relating to Accounting policies, internal control, financial reporting functions, internal audit, risk assessment and regulatory compliance of RBSH Group.

Bruce Van Saun
Chairman of the Supervisory Board

Risk & Audit Committee

The members of the Risk & Audit Committee are appointed by the Supervisory Board from its own members. The Committee derives its authority from the Supervisory Board, the RBSG Group Board Risk Committee and the RBSG Group Audit Committee. Its Terms of Reference are set out in annex C of the Rules Governing the Supervisory Board's Principles and Best Practices, which are published on www.rbs.nl. In line with good corporate governance, the Terms of Reference governing the Risk & Audit Committee have been reviewed to ensure that objectives are, where possible, fully aligned and consistent with the Terms of Reference of both the RBSG Group Audit Committee and the RBSG Group Board Risk Committee and adequate and appropriate oversight and escalation mechanisms are implemented. Also, the Terms of Reference have been reviewed and adjusted in light of the requirements as stated in the Code Banken.

The external auditor is appointed by the General Meeting of Shareholders for a period of one year on the advice of the Supervisory Board. The Risk & Audit Committee has the delegated responsibility for the engagement of the external auditor. For this purpose it evaluates and reports the independence of the external auditor, the measures used to control the quality of the external auditor's work, and the annual audit budget. The Risk & Audit Committee's policy on auditor independence governs the appointment, compensation, and oversight of the external auditor. To ensure the external auditor's independence, the Auditor Independence Policy prohibits the external auditor from providing certain non-audit services to RBSH Group.

The Risk & Audit Committee has delegated responsibility for pre-approving audit, audit-related and permitted non-audit services provided by the external auditor, to the Chief Financial Officer (CFO). In exercising its pre-approval authority, the CFO considers whether the proposed services are consistent with the continued independence of the external auditor.

During each meeting of the Risk & Audit Committee, an overview is presented of the non-audit services that were initiated during the period under review.

Composition of the Risk & Audit Committee

In 2012, the Risk & Audit Committee was chaired by Bruce Van Saun. Other members included Christopher Campbell, Ron Teerlink, Sietze Hepkema and Henk Rottinghuis.

The members of the Risk & Audit Committee collectively have sufficient accounting and financial management expertise to understand RBSH Group’s business, financial statements and risk profile. Furthermore, the Supervisory Board has determined that Bruce Van Saun possesses the necessary relevant expertise in financial administration and accounting for listed companies and other large companies and therefore qualifies as a financial expert within the meaning of the Dutch Corporate Governance Code. It has also been determined that Bruce Van Saun qualifies as an audit committee financial expert in accordance with Section 407 of the Sarbanes-Oxley Act.

Activities of the Risk & Audit Committee

The Risk & Audit Committee convened five times during the course of 2012. All of the meetings were scheduled meetings. The Risk & Audit Committee reviewed, discussed and advised the Supervisory Board with regard to the interim financial statements, the Annual Report, the external auditor’s report, the external auditor’s management letter including the Managing Board’s related comments, the evaluation of the design and operating effectiveness of the internal risk management and control systems, the Capital Adequacy Framework and the application of the US Sarbanes-Oxley Act, in particular as to RBSH Group’s compliance with the requirements of Section 404 of this Act. Deloitte Accountants B.V. (Deloitte) reported on its independence to the Risk & Audit Committee. None of these processes have identified findings that call into question the independence of Deloitte.

The Risk & Audit Committee reviewed its pre-approval policy for audit and non-audit services provided by the external auditor. Following this review the Risk & Audit Committee pre-approved the nature and the budget for audit, audit-related and non-audit services, in line with this policy. Throughout the period, representatives of RBSH Group’s Managing Board, Finance Officers, the Committee Secretary, representatives from Group Internal Audit, Risk Management and the external auditor have been in attendance by standing invitation and were provided with copies of the agendas, papers and minutes.

The Risk & Audit Committee, in the presence of senior representatives from Risk Management, also reviewed and discussed RBSH Group’s overall risk profile, the quality of the loan portfolio and RBSH Group’s large exposures and provisioning for loan losses. In addition, the Committee reviewed various risk reports, produced both internally and by third parties. The Risk & Audit Committee reviewed, discussed and approved the 2012 Audit Plan prepared by RBSG Group Internal Audit, as well as staff matters including training and recruitment. In addition, the Risk & Audit Committee discussed the operational and internal control aspects covered by RBSG Group Internal Audit in its audit reviews presented to the committee.

Boards and Committees continued

The report of the Managing Board

The members of the Managing Board of RBS Holdings collectively manage RBS Holdings and are responsible for the general affairs of RBS Holdings business and general affairs of all its subsidiaries. The members are appointed by the General Meeting of Shareholders.

The Supervisory Board of RBS Holdings nominates one or more candidates for each vacant seat. If the Supervisory Board nominates two or more candidates for a vacant seat in the Managing Board, the nomination list is binding. The members of the Managing Board are accountable both collectively and individually for all decisions taken by the Managing Board.

The Chairman of the Managing Board leads the Managing Board in its overall management of RBSH Group to achieve its performance goals and ambitions. The Chairman of the Managing Board is the main point of liaison with the Supervisory Board. The Chief Financial Officer is responsible for the financial affairs of RBSH Group, and the Chief Risk Officer is responsible for RBSH Group's risk management and operational risk control. Alongside their overall corporate responsibilities, the members of the Managing Board are responsible for the management of the divisions and control and support functions. The Managing Board has delegated certain tasks to a number of Managing Board committees which are described on page 109 of this report.

The members of the Managing Board as at 27 March 2013 are as follow:

		Date of first appointment	Date for re-election
Jan de Ruiter (Chairman)	(51, Dutch, m)	1 April 2010	1 April 2014
Pieter van der Harst	(53, Dutch, m)	27 July 2010	27 July 2014
Jeroen Kremers (Vice-Chairman)	(54, Dutch, m)	1 July 2009	1 July 2013
Michael Geslak	(49, American, m)	1 April 2010	1 April 2014
Richard Hemsley	(48, British, m)	13 October 2011	13 October 2015

See page 104 for notes to this table.

Corporate governance continued

Boards and Committees: The report of the Managing Board continued

Jan de Ruiter

Chairman Managing Board and Head of Markets RBS N.V. – RBSG Group Netherlands Country Executive

Mr. de Ruiter started his career at the Dutch Credit Insurance (NCM) in 1984 and moved to ABN Bank in 1987. During his 21 years with ABN AMRO, he held various positions in the wholesale division of the bank. From 1987 until 1993 he was a team member of the Institutional Equity Sales team in Amsterdam and from 1993 until 1998 Head of the European Equity sales team, based in London. In 1998 he became the Head of Equity Capital Markets for the Netherlands (Managing Director ABN AMRO Rothschild). Mr. de Ruiter was appointed Corporate Managing Director of ABN AMRO in 2000. In 2003 he became one of the two joint CEO's of ABN AMRO Rothschild. In 2004 he also became responsible for the global Merger & Acquisitions franchise of ABN AMRO. He held both positions until the end of 2007. At the beginning of 2008, following the successful consortium bid for ABN AMRO, he became the country executive of RBS N.V. in the Netherlands. Mr. de Ruiter graduated from the HEAO in Utrecht in 1983 (Economics/Law) and also holds an MBA degree from Webster University.

Jeroen Kremers

Chief Risk Officer and Vice Chairman Managing Board, RBS N.V. – RBSG Group Head of Global Country Risk

Mr. Kremers has been Head of Global Country Risk at the Royal Bank of Scotland Group since March 2009, and joined the ABN AMRO Managing Board as of 1 July 2009. He began his career in 1986 as an Economist for the International Monetary Fund in Washington DC. In 1989 he became Senior Economist at the Netherlands Ministry of Finance, and in 1992, Deputy Director for Financial and Economic Policy. He then moved to become Director for Financial Markets in 1997 and in addition was appointed Deputy Treasurer General. He also was a Professor of Economics at Erasmus University Rotterdam from 1991 until 2003. In 2003, Mr. Kremers left the Ministry and was elected Executive Director of the International Monetary Fund, representing a constituency of 13 European countries. He remained there until 2007, when he moved to ABN AMRO to become Head of Group Public Affairs. He left ABN AMRO in 2008 and in 2009 moved to RBS. He earned a DPhil at Nuffield College Oxford in 1985, following degrees in Quantitative Economics at Bristol University and in Econometrics at Tilburg University. Mr. Kremers is a member of the Senior Advisory Board of Oliver Wyman Financial Services as well as of the Supervisory Board of Maastricht University and of N.V. Nederlandse Spoorwegen.

Pieter van der Harst

Chief Financial Officer, RBS N.V. - RBSG Group Netherlands Chief Financial Officer

Mr. van der Harst obtained a Degree in Economics in 1985 at the Erasmus University in Rotterdam. He started his career at the Dutch subsidiary of Banque Indosuez, where, after several functions in risk management and operations, he became Director of Financial Markets in 1993.

After the sale of this entity to Dutch savings bank SNS Bank in 1997, he served as Managing Director of SNS Financial Markets, leading the treasury, funding and trading activities of the bank. Mr van der Harst joined ABN AMRO in 2000 as Finance Director at Bouwfonds, a subsidiary active in residential mortgages and real estate development, finance and asset management. Following the sale of Bouwfonds in 2006, he joined ABN AMRO's corporate development team. From June 2007 to September 2007 he was acting CFO at ABN AMRO Asset Management. From September 2007 through May 2008 he served as CFO for ABN AMRO's business unit North America. From June 2008 to the legal separation date of 1 April 2010, he fulfilled the role of RBSG Groups' share of RBS Holdings N.V.'s CFO in addition to his role of CFO for RBSG Group in the Netherlands. Currently, he continues to serve as CFO for RBSH Group.

Michael Geslak
Chief Administrative Officer – RBS N.V.
Mr. Geslak joined ABN AMRO in New York in 1988 as an accountant, in 1992 he formed the Market Risk function in New York, and after moving to Chicago in 1993 became Head of Market Risk for North America. In 1995 he became Head of Investment Banking Operations and Product Control in Chicago, which was later expanded to cover all Investment Banking Operations for North America. In 2000 he was promoted to Chief Administrative Officer for Wholesale Banking in the Americas.

Mr. Geslak then moved to London as Global Chief Information Officer for ABN AMRO Wholesale Banking and managed the provision of all technology to the Global Markets and Global Transaction Services businesses. In 2006 he became Head of Services for Global Markets and EMEA. From 2009 to 2012 he became the RBSG Group COO for EMEA. His current roles are CAO and Managing Board member for RBS N.V. and Business Services Business Partner for Non-Core and APS.

In addition to these responsibilities, for the past two years Mr. Geslak has been leading the programme to de-risk RBS N.V. by transferring businesses to RBS plc.

Richard Hemsley
Head of International Banking, RBS N.V. - RBSG Group Chief Logistics Officer for International Banking
Mr. Hemsley is Chief Logistics Officer for International Banking having previously been Chief Operating Officer for Global Transaction Services, a role which he took up in January 2011. Amongst Mr. Hemsley’s responsibilities are to ensure Operations and Technology infrastructures are optimised and best practices are shared with Markets. He also co-ordinates with RBSG Group’s Business Services Division to enhance efficiency front-to-back connectivity, drive efficiency, tackle cost base and improve operational risk management.

Corporate governance continued

Boards and Committees: The report of the Managing Board continued

Mr. Hemsley joined RBSG Group (with NatWest) in 1983 holding a wide variety of roles in Retail Banking, Corporate Banking and Head Office functions. In 2000 he became Head of Lending Operations, Group Manufacturing, in 2004 he was appointed to Director, Group Security & Fraud and following on from this in 2005 his career progressed to MD, Manufacturing Operations with key responsibilities for customer service improvement whilst delivering a 30% improvement in productivity.

A Fellow of the Chartered Institute of Bankers in Scotland, Mr. Hemsley has also completed the Advanced Management Programme at Harvard Business School.

Information, induction and professional development

As part of the Code Banken, both the Managing Board and the Supervisory Board participate in a programme of Life Long Learning. The programme consists of a modular approach, addressing matters that are mentioned in the Code Banken, including relevant developments in the financial sector in general and the banking sector in specific, corporate governance in general the duty of care towards clients, integrity, risk management, financial reporting and audits.Subject matter experts are invited, both from within RBSH Group and from outside RBSH Group, to deliver education modules on the above mentioned matters.

Performance evaluation

The members of the Managing Board participate in the annual performance management process of RBSG Group.

Managing Board committees

In order to provide effective oversight and leadership, the Managing Board has established four sub-committees, the Risk & Control Committee, the Asset & Liability Management Committee (ALCO), the Disclosure Committee and the Power of Attorney Committee (PoA).

Risk & Control Committee (RCC)

The Risk & Control Committee (RCC) oversees the risk framework within RBSH Group, monitors the actual risk profile and advises the Managing Board on these matters. Its scope is, amongst others, credit, market, operational and regulatory risk within RBSH Group.

Asset & Liability Management Committee (ALCO)

The Managing Board has delegated to the ALCO the responsibility for the management of capital, liquidity, interest rate risk and foreign exchange risk. This includes responsibility for reviewing, approving and allocating balance sheet, capital, liquidity and funding limits.

Disclosure Committee

The Disclosure Committee advises and assists the Managing Board in fulfilling its responsibilities for overseeing the accuracy and timeliness of public disclosures made by RBSH Group. This inter alia includes advising the Managing Board on the disclosure of financial information.

Power of Attorney Committee

The PoA Committee has the authority to appoint holders of a Senior or a Divisional Power of Attorney (in relation to

Markets, International Banking, Business Services, Global Restructuring Group and Non-Core Division) on behalf of RBS N.V.

Code of conduct

The code of conduct applies to everyone who works for RBS. It promotes honest and ethical conduct, including the handling of actual or apparent conflicts of interest between personal and professional relationships. RBSH Group recognises that personal conduct, business integrity and RBSH Group's security are crucial, and the code of conduct serves to inform those who work for us of RBSH Group's expectations of their behaviour and practices.

The code of conduct is available on RBSG Group's website www.rbs.com

Sustainability

Sustainability is central to the way RBSH Group is managed. Sustainability is not just about the many responsibilities and obligations that RBSH Group has in a legal sense, but about specific issues that need to be addressed to ensure that RBSH Group is a business operating on a sustainable basis. There is a clear governance structure for RBSG Group Sustainability that oversees and aligns RBSG Group's approach to the range of ethical, social and environmental issues which confront the business on a daily basis.

RBSG Group continues to do significant work and address challenges across five key themes: Fair banking, Supporting enterprise, Employee engagement, Safety and security and Citizenship and environmental sustainability.

RBSG Group Sustainability Committee

The RBSG Group Sustainability Committee comprises of independent non-executive directors and is chaired by the Senior Independent Director.

During 2012, the Group Sustainability Committee focused on reviewing the Group's overall sustainability strategy, values and policies and aligning the Group's approach to ethical, social and environmental issues. The role, responsibilities and membership of the Committee were reviewed at the end of 2012 as part of the Group's Purpose, Vision and Values programme. In 2013, the Committee's scope will widen to include:-

- sustainability and reputational issues related to customer and citizenship activities;
- oversight of the delivery of the Purpose, Vision and Values cultural and behavioural change; and
- oversight of the sustainability aspects of the people agenda.

In addition, the Committee will be responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups, except where such issues have already been dealt with by other Board Committees.

Corporate governance continued

Relations with shareholders

Rights of shareholders

Any resolution to amend the Articles of Association of RBS Holdings may only be passed by the General Meeting of Shareholders following a proposal by the Managing Board which has been approved by the Supervisory Board. A copy of the proposal containing the literal text of the proposed amendments shall be made available for inspection by the holders of shares of RBS Holdings at the offices of RBS Holdings and at the offices stated in the convocation to the meeting, from the day of convocation to the end of the Meeting. Each Shareholder may obtain a full copy of the proposal free of charge.

Meetings of shareholders and convocation

The general meetings of shareholders shall be held in Amsterdam, or in The Hague, Rotterdam, Utrecht or Haarlemmermeer (Schiphol). Annual General Meeting of Shareholders must be held within six months of the end of each financial year. In addition, general meetings of shareholders shall be held as frequently as deemed necessary by the Managing Board or the Supervisory Board and when required by law or by the Articles of Association. General meetings of shareholders shall be convened by the Managing Board or the Supervisory Board, without prejudice to the provisions of Sections 110, 111 and 112 of Book 2 of the Netherlands Civil Code. Convocation shall take place not later than on the fifteenth day prior to the day of the meeting. Convocation shall state the items to be discussed or alternatively notice shall be given that such items may be inspected at the company's offices. Proposals to amend the Articles of Association or proposals relating to a reduction of the company's capital shall always be included in the actual convocation.

Employees

As at 31 December 2012, RBSH Group employed over 11.3 thousand employees (full-time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the accounts.

Employee learning and development

RBSH Group maintains a strong commitment to providing all its employees with the opportunity to grow through learning and development, which in turn helps to achieve business objectives and drive excellent customer service. This helps our employees deliver the best service to our customers whilst working towards a recognised professional standard. Employee volunteering schemes make it easy for individuals and teams to give something back to their communities and make a real difference.

Employee communication

Employee engagement is encouraged through a range of communication channels, at both divisional and Group level. These channels provide access to news and information in a number of ways, including the intranet, magazines, video, team meetings led by line managers, briefings held by senior managers and regular dialogue with employees and employee representatives.

The Managing Board and other senior RBSH Group executives regularly communicate with, and encourage feedback from, employees across a range of channels.

Employee feedback

Every year since 1999, through the Your Feedback survey, employees in all our businesses have shared their thoughts about what it's like working for RBS. These insights inform what RBSH Group needs to do to improve the way it works, whether it's a local issue or something that affects everyone.

Apart from an opportunity to listen to employees, the survey also enables RBSH Group to monitor levels of employee satisfaction and engagement and how these compare with other companies.

Employee consultation

RBSH Group recognises employee representative organisations such as trade unions and work councils in a number of businesses and countries.

RBSG Group has a European Employee Council that provides elected representatives with an opportunity to understand better RBSG Group's European operations.

Diversity and inclusion

During 2012, RBSG Group executive renewed its commitment to making workplace policies, processes and experiences inclusive for staff, customers and stakeholders; in support of this, RBSG Group HR has set Equality, Diversity & Inclusion within its top priorities for 2013.

Inclusion is built into the recruitment process, positive action programmes developing talent, flexible working policies and support for dependent care, ill-health and disability-related absence. RBSG Group continues to support disabled people ensuring they have equal opportunities to recruitment, employment, promotion and training.

RBSG Group also supports employee led networks such as Focused Women and Rainbow who provide personal and career development opportunities through networking and training events.

This commitment to inclusion extends to supporting and participating in positive action programmes outside of RBSG Group aimed at cultivating future leaders including, 'An Inspirational Journey', the FTSE-100 cross-company mentoring and Glass Ladder programmes. RBSG Group continues to maintain its involvement with external charitable networks and events such as Manchester Pride.

This approach to inclusion extends to the marketplace with the RBSG Group Women in Business Specialists supporting and guiding more and more women to take the step of starting their own business.

Further details on the Board diversity policy can be found at www.rbs.com.

This year RBSG Group has been recognised for its work on Equality, Diversity and Inclusion by retaining our Gold standard ranking from Opportunity Now (gender), achieving Silver for Race for Opportunity (Race), attaining the Top Employers award for employee engagement from workingmums.co.uk as well as securing a position in the Working families Top 10.

Corporate governance continued

Employees continued

Safety, health and wellbeing

Ensuring the safety, health and wellbeing of employees and customers is an important responsibility for RBSH Group.

RBSH Group is committed to ensuring legal compliance and managing health and safety risks. During 2012, increased focus on leadership, governance and the effectiveness of controls delivered improvements in health and safety performance.

A wide range of health benefits and services are in place to help employees maintain good physical and psychological health, and support them if they do become unwell. A number of these services have been enhanced and promoted in response to the impact of the economic environment. For example, this year we launched an online toolkit which provides easy access to a range of resources, provided through our Employee Assistance Programme, to help employees deal with stress, build resilience and manage personal finances.

Pre-employment screening

RBSH Group has a comprehensive pre-employment screening process to guard against possible infiltration and employee-related fraud for all direct and non-direct staff engaged on Group business.

The Dutch Banking Code (Code Banken)

Introduction

The Code Banken was drawn up by the Netherlands Bankers' Association (NVB) in response to the report entitled 'Restoring Trust' (Naar herstel van vertrouwen), which was published by the Advisory Committee on the Future of Banks (Adviescommissie Toekomst Banken) on 7 April 2009. The recommendations of the Advisory Committee’s report have been used as the basis for this Code Banken. The Code Banken is mandatory for RBSH Group as stated in Book 2 of the Civil Code as from 1 January 2010.

The Code Banken offers specific provisions, but underlying these provisions, its aim is to instil learning in the banking sector following the financial crisis. Drawing lessons and implementing change with the aim to restore trust among all our stakeholders, clients, staff, investors and society at large. RBSG Group, including RBSH Group has undergone and continues to undergo profound change following the crisis and is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Corporate Governance codes and the global footprint of RBSG Group

RBSH Group is ultimately owned by RBSG Group. When implementing the Code Banken, the Managing Board and Supervisory Board of RBSH Group will take into account the effects of similar codes of conduct implemented in the RBSG Group with the aim to align all businesses with RBSG Group.

Clients First

RBSH Group is aware of the fact that its long term success fully depends on how successful RBSH Group is in servicing its clients. To that extent, RBSH Group has taken additional measures to further embed ‘a client led culture’ in the organization. Over the past few years certain themes in this area have been fleshed out in detail, resulting in the ‘Customer Charter’ and the ‘Treating Customers Fairly Policy’. The Customer Charter describes 14 ‘customer commitments’ divided into the following four categories: