ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
April 30, 2014

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, 2013

OR

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

OR

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

Commission file number: 001-10306

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

United Kingdom
(Jurisdiction of incorporation)

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

Aileen Taylor, Group Secretary, Tel: +44 (0) 131 626 4099, Fax: +44 (0) 131 626 3081

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

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

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing 2 ordinary shares, nominal value £1 per share	New York Stock Exchange
Ordinary shares, nominal value £1 per share	New York Stock Exchange*
American Depositary Shares Series F, H, L, M, N, P, Q, R, S, T and U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, M, N, P, Q, R, S, T and U respectively	New York Stock Exchange
3.250% Senior Notes due 2014	New York Stock Exchange
3.950% Senior Notes due 2015	New York Stock Exchange
4.875% Senior Notes due 2015	New York Stock Exchange
2.550% Senior Notes due 2015	New York Stock Exchange
4.375% Senior Notes due 2016	New York Stock Exchange
Floating Rate Senior Note due 2017	New York Stock Exchange
1.875% Senior Notes due 2017	New York Stock Exchange
5.625% Senior Notes due 2020	New York Stock Exchange
6.125% Senior Notes due 2021	New York Stock Exchange
6.125% Subordinated Tier 2 Notes due 2022	New York Stock Exchange
6.000% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
6.100% Subordinated Tier 2 Notes due 2023	New York Stock Exchange
Structured HybrId Equity Linked Securities (SHIELDS) due January 16 2014 linked to the S&P 500 Index	NYSE MKT
Leveraged CPI Linked Securities due January 13, 2020	NYSE MKT
RBS US Large Cap TrendpilotTM Exchange Traded Notes due December 7, 2040	NYSE Arca
RBS US Mid Cap TrendpilotTM Exchange Traded Notes due January 25, 2041	NYSE Arca
RBS Gold TrendpilotTM Exchange Traded Notes due February 15, 2041	NYSE Arca
RBS Oil TrendpilotTM Exchange Traded Notes due September 13, 2041	NYSE Arca
RBS Global Big Pharma Exchange Traded Notes due October 25, 2041	NYSE Arca
RBS NASDAQ-100® TrendpilotTM Exchange Traded Notes due December 13, 2041	NYSE Arca
RBS China TrendpilotTM Exchange Traded Notes due April 18, 2042	NYSE Arca
RBS US Large Cap Alternator Exchange Traded NotesTM due September 5, 2042	NYSE Arca
RBS Rogers Enhanced Commodity Index Exchange Traded Notes due October 29, 2042	NYSE Arca
RBS Rogers Enhanced Agriculture Exchange Traded Notes due October 29, 2042	NYSE Arca
RBS Rogers Enhanced Energy Exchange Traded Notes due October 29, 2042	NYSE Arca

RBS Rogers Enhanced Precious Metals Exchange Traded Notes due October 29, 2042	NYSE Arca
RBS Rogers Enhanced Industrial Metals Exchange Traded Notes due October 29, 2042	NYSE Arca

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2013, the close of the period covered by the annual report:

(Title of each class)	(Number of outstanding shares)
Ordinary shares of £1 each	6,203,022,294
B Shares	51,000,000,000
Dividend Access Share	1
11% cumulative preference shares	500,000
5½% cumulative preference shares	400,000
Non-cumulative dollar preference shares, Series F, H and L to U	209,609,154
Non-cumulative convertible dollar preference shares, Series 1	64,772
Non-cumulative euro preference shares, Series 1 to 3	2,044,418
Non-cumulative convertible sterling preference shares, Series 1	14,866
Non-cumulative sterling preference shares, Series 1	54,442

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

x Yes o 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 x Accelerated filer o Non-Accelerated filer o

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

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

SEC Form 20-F cross reference guide

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

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

The geographic analysis in the Business Review, including the average balance sheet and interest rates, changes in net interest income and average interest rates, yields, spreads and margins in this report have generally been compiled on the basis of location of office - UK and overseas – unless indicated otherwise. ‘UK’ in this context includes transactions conducted through the offices in the UK which service international banking transactions.

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

International Financial Reporting Standards
As required by the Companies Act 2006 and Article 4 of the European Union IAS Regulation, the consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union (together ‘IFRS’). They also comply with IFRS as issued by the IASB.

Non-GAAP financial information
The directors manage the Group’s performance by class of business, before certain reconciling items, as is presented in the segmental analysis on pages 478 to 485 (the “managed basis”). Discussion of the Group’s performance focuses on the managed basis as the Group believes that such measures allow a more meaningful analysis of the Group’s financial condition and the results of its operations. These measures are non-GAAP financial measures. A body of generally accepted accounting principles such as IFRS is commonly referred to as ‘GAAP’. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure. Reconciliations of these non-GAAP measures are presented throughout this document or in the segmental analysis on pages 478 to 485. These non-GAAP financial measures are not a substitute for GAAP measures. Furthermore, RBS has divided its operations into “Core” and “Non-Core”. Certain measures disclosed in this document for Core operations and used by RBS management are non-GAAP financial measures as they represent a combination of all reportable segments with the exception of Non-Core. In addition, RBS has further divided parts of the Core business into “Retail & Commercial” consisting of the UK Retail, UK Corporate, Wealth, International Banking, Ulster Bank and US Retail & Commercial divisions. This is a non-GAAP financial measure. Furthermore, RBS has presented certain measures “excluding RBS Capital resolution (RCR)” which are deemed non-GAAP measures. Lastly, the Basel III net stable funding ratio, fully loaded Basel III ratio, liquidity coverage ratio, stressed outflow coverage and further metrics included in the Risk and balance sheet management section of this document represent non-GAAP financial measures given they are metrics that are not yet required to be disclosed by a government, governmental authority or self-regulatory organisation.

Forward-looking statements

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

In particular, this document includes forward-looking statements relating, but not limited to: the Group’s restructuring and new strategic plans, divestments, capitalisation, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), return on equity (ROE), profitability, cost:income ratios, leverage and loan:deposit ratios, funding and risk profile; discretionary coupon and dividend payments; implementation of legislation of ring-fencing and bail-in measures; sustainability targets; litigation, regulatory and governmental investigations; the Group’s future financial performance; the level and extent of future impairments and write-downs; and the Group’s exposure to political risks, including the referendum on Scottish independence, credit rating risk and 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 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: global economic and financial market conditions and other geopolitical risks, and their impact on the financial industry in general and on the Group in particular; the ability to implement strategic plans on a timely basis, or at all, including the simplification of the Group’s structure, the divestment of Citizens Financial Group and the exiting of assets in RBS Capital Resolution as well as the disposal of certain other assets and businesses as announced or required as part of the State Aid restructuring plan; the achievement of capital and costs reduction targets; ineffective management of capital or changes to capital adequacy or liquidity requirements; organisational restructuring in response to legislation and regulation in the

United Kingdom (UK), the European Union (EU) and the United States (US); the implementation of key legislation and regulation including the UK Financial Services (Banking Reform Act) 2013 and the proposed EU Recovery and Resolution Directive; the ability to access sufficient sources of capital, liquidity and funding when required; deteriorations in borrower and counterparty credit quality; litigation, government and regulatory investigations including investigations relating to the setting of LIBOR and other interest rates and foreign exchange trading and rate setting activities; costs or exposures borne by the Group arising out of the origination or sale of mortgages or mortgage-backed securities in the US; the extent of future write-downs and impairment charges caused by depressed asset valuations; the value and effectiveness of any credit protection purchased by the Group; unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices and basis, volatility and correlation risks; changes in the credit ratings of the Group; changes to the valuation of financial instruments recorded at fair value; competition and consolidation in the banking sector; the ability of the Group to attract or retain senior management or other key employees; regulatory or legal changes (including those requiring any restructuring of the Group’s operations) in the UK, the US and other countries in which the Group operates or a change in UK Government policy; changes to regulatory requirements relating to capital and liquidity; changes to the monetary and interest rate policies of central banks and other governmental and regulatory bodies; changes in UK and foreign laws, regulations, accounting standards and taxes, including changes in regulatory capital regulations and liquidity requirements; impairments of goodwill; pension fund shortfalls; general operational risks; HM Treasury exercising influence over the operations of the Group; reputational risk; the conversion of the B Shares in accordance with their terms; limitations on, or additional requirements imposed on, the Group's activities as a result of HM Treasury's investment in the Group; and the success of the Group in managing the risks involved in the foregoing.

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

The information, statements and opinions contained in this 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.

Recent developments

Completion of sale of remaining interest in Direct Line Insurance Group (DLG)

Further to the announcement on 26 February 2014, RBS completed the sale of its remaining interest of 423.2 million ordinary shares in DLG on 27 February 2014 at a price of £2.63 pence per share, raising gross proceeds of £1,113 million.

RBS has now sold all its ordinary shares in DLG except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to DLG management.

The sale marks the completion of RBS's EC-mandated disposal of its interest in DLG.

Board change

On 27 February 2014, RBS announced that Philip Scott, a non-executive Director, will step down from the Board by 31 October 2014.

On 7 March 2014, RBS announced the appointment of Morten Friis as a non-executive Director with effect from 10 April 2014.

Also on 7 March 2014, RBS announced that Anthony Di Iorio, a non-executive director, would step down from the Board on 26 March 2014.

On 4 April 2014, RBS announced that Ewen Stevenson had been appointed as an executive director and RBS Chief Financial Officer with effect from 19 May 2014.

Dividend Access Share and revised State Aid terms

The Company announced on 9 April 2014 that it had entered into an agreement ('DAS Retirement Agreement') with Her Majesty's Treasury ('HMT') to provide for the future retirement of the Dividend Access Share ('DAS') subject to the approval by the Company's independent shareholders. The DAS Retirement Agreement sets out the process for removal of the DAS - a key element of the Government's 2009 capital injection into the Company and the associated European Commission approval of the State Aid package for the bank. Among other benefits, the retirement of the DAS will in future allow the Board of the Company to state more clearly a dividend policy to existing and potential investors.

The DAS was an important factor in the EC's assessment of the State aid RBS received and was part of the basis for its approval of that support in 2009. It was therefore necessary for the proposal for the eventual retirement of the DAS to be notified to the EC by HMT and this was done by HMT.

The EC concluded that the new arrangements for the eventual retirement of the DAS did not constitute new State aid and approved the changes to the Company's restructuring plan in its State Aid Amendment Decision of 9 April 2014. In addition, this decision included two further key commitments made by HMT to the EC as follows:

- The deadline for the Company's divestment of the Williams & Glyn business (by initial public offering, whole business sale or tendering procedure for its entire interest) has been extended. In the expected event of divestment by IPO, the Company must carry out this IPO before 31 December 2016 and complete the disposal of its entire interest in the Williams & Glyn business by 31 December 2017.

- Citizens Financial Group, Inc. ('Citizens') will be disposed of by 31 December 2016, with an automatic 12 month extension if market metrics indicate that an IPO or subsequent tranches of disposal cannot be completed in an orderly fashion or at a fair value. On 1 November 2013, RBS announced that it would accelerate the divestment of Citizens with a partial IPO and that it planned to fully divest the business by the end of 2016. The obligation under the State Aid Amendment Decision to dispose of Citizens is therefore in line with the Company's planned and publicly stated divestment timetable and already reflected in its capital and strategic planning.

The Company has entered into a Revised State Aid Commitment Deed under which it undertakes to do all acts and things necessary to ensure that HMT is able to comply with the revised State aid commitments made by HMT to the EC. HMT's obligations to the EC and the Company's commitments under the Revised State Aid Commitment Deed will remain in effect even if the DAS Retirement Agreement is not approved by independent shareholders.

Tomlinson Report

As discussed in more detail on page 470, in response to the Tomlinson Report, the Bank instructed the law firm Clifford Chance to conduct an independent review of the principal allegation made in the Tomlinson Report. Clifford Chance published its report on 17 April 2014 and concluded that there was no evidence to support the principal allegation. The Group continues to cooperate fully with the ongoing FCA investigation.

Card Protection Plan Limited

As discussed on page 470, the FCA announced on 22 August 2013 that Card Protection Plan Limited (CPP) and 13 banks and credit card issuers, including the Group, had agreed to a compensation scheme in relation to the sale of card and/or identity protection insurance to certain retail customers. The compensation scheme has now been approved by the requisite number of customers and by the High Court of England and Wales. CPP has written to affected policyholders to ask those who believe they have been mis-sold to submit their claims. Claims that have been submitted to date are currently being processed. Save for exceptional cases, all claims must be submitted before 31 August 2014. The Group has made appropriate levels of provision based on its estimate of ultimate exposure.

SME banking market study

As discussed on page 472, the OFT announced its market study on competition in banking for SMEs in England and Wales, Scotland and Northern Ireland on 19 June 2013. Following a consultation on the scope of the market study, the OFT published an update paper on 27 September 2013 setting out its proposed scope. On 11 March 2014, the OFT set out some competition concerns on SME banking but also announced that its successor body, the CMA, would continue the review. On the same day, the CMA indicated that it expected to come to a provisional decision on whether or not to refer SME banking to a more detailed phase 2 investigation by Summer 2014.

Cap on variable remuneration

The fourth EU Capital Requirements Directive (CRD IV), implemented for banks in the UK by the Prudential Regulatory Authority, imposes a 1:1 cap on variable remuneration in relation to salary; however with shareholder approval it is possible to award variable remuneration up to 200% of fixed pay (i.e. a 2:1 cap).

All of our major competitors have indicated that they will seek approval from their shareholders to introduce a 2:1 cap and the Board believes the best commercial solution for RBS would be to have the flexibility on variable compensation which is now emerging as the sector norm. This would also allow RBS to maintain the maximum amount of compensation that could be subject to performance conditions including claw back for conduct issues that may emerge in future.

On 24 April UKFI informed the board that it would vote against any resolution which proposes a 2:1 ratio. In these circumstances, the Board expects that such a resolution would fail and will therefore not be brought to the Annual General Meeting. HM Treasury has commented that it considers an increase to the cap on variable remuneration cannot be justified whilst RBS has yet to complete its restructuring and remains a majority publicly-owned bank, and notes that as a result of its pay policy RBS will remain a 'back-marker' in its overall remuneration compared to other banks.

The Board acknowledges that this outcome creates a commercial and prudential risk which it must try to mitigate within the framework of a 1:1 fixed to variable compensation ratio.

Moody's Investors Service

On 13 March 2014, Moody's closed a second ratings review, first initiated on 12 February 2014 on RBS Group by lowering the credit ratings of RBSG and certain subsidiaries by one notch. The long term ratings of RBSG was lowered to 'Baa2' from 'Baa1' whilst the long term ratings of RBS plc and National Westminster Bank Plc were lowered to 'Baa1' from 'A3'. Short term ratings were affirmed as unchanged. Post the review, the ratings outlook assigned was negative.

The ratings of Ulster Bank Ltd and Ulster Bank Ireland Ltd's were impacted by the rating action on the RBS Group. Moody's lowered its long term and short term ratings of these entities by 1-notch to 'Baa3' (long term)/'P-3' (short term) from 'Baa2'/'P-2'. A negative outlook was assigned to ratings, in line with the outlook on the RBS Group.

The long term ratings of subsidiaries, RBS Citizens National Association and Citizens Bank of Pennsylvania were not impacted by the rating action on the RBS Group and long term ratings of these entities were affirmed as unchanged by Moody's. Ratings are on a negative outlook.

Standard & Poor's

There have been no significant rating actions on RBS Group plc and its subsidiaries by Standard & Poor's. However, on 23 April 2014 they published a report setting out their views on potential risks for banks and key considerations for rating banks in an independent Scotland.

2013 Financial Results

RBS reports a pre-tax loss for 2013 of £8,243 million, including regulatory and redress provisions of £3,844 million, and impairments and other losses of £4,823 million related to the establishment of RBS Capital Resolution (RCR).

Excluding the impact of the creation of RCR, RBS operating profit on a managed basis was £2,520 million, down 15% from 2012:

RBS has, on 27 February 2014, updated on its comprehensive business review, aimed at transforming the bank (see page 10).

2013 Financial Results

Third party assets were reduced by £130 billion over the course of 2013, with Markets down £72 billion and Non-Core down £29 billion. In the five years since the end of 2008, the funded balance sheet has been reduced by £487 billion and total assets by £1,191 billion.

The Core Tier 1 ratio was 10.9% at 31 December 2013. On a fully loaded Basel III basis, the Common Equity Tier 1 ratio was 8.6%. The impact of the regulatory and redress provisions booked in Q4 2013 was already reflected in our future capital plan, and RBS continues to target a fully loaded Basel III Common Equity Tier 1 ratio of c.11% by the end of 2015 and 12% or above by the end of 2016.

Continued improvement in credit quality, particularly in the UK Retail and Non- Core portfolios, saw risk elements in lending fall by 4%. Reflecting the increased impairments associated with the creation of RCR, provision coverage increased from 52% at end 2012 to 64% at end 2013.

RBS remains highly liquid, with short-term wholesale funding down £10 billion to £32 billion at the end of 2013, covered more than four times by a £146 billion liquidity portfolio.

Building a bank that is trusted by its customers
RBS has announced a refreshed strategic direction with the ambition of building a bank that earns its customers' trust by serving them better than any other bank.

RBS will be structured around the needs of its customers, with seven existing operating divisions realigned into three businesses: Personal & Business Banking, Commercial & Private Banking and Corporate & Institutional Banking.

Ulster Bank in Northern Ireland will benefit from a closer integration with our personal, business and commercial banking franchises in Great Britain. We are continuing to explore further opportunities in the Republic of Ireland with a view to being a challenger to the systemic banks.

To position RBS to deliver a sustainable overall return on tangible equity of 12% plus in the long term, we must achieve a significant reduction in costs and complexity.

This simplification is intended to deliver significant improvements to services delivered to our customers while at the same time helping to bring our cost base down from £13.3 billion in 2013 to £8 billion in the medium term (1).

Future performance will be reported against customer and financial measures. Further details are set out on page 12.

Operating results
RBS recorded an operating loss of £8,243 million. On a managed basis RBS recorded an operating profit of £2,520 million excluding the impact of the creation of RCR which reduced income by £333 million and increased impairments by £4,490 million. Including these RCR-related impairment and other losses of £4,823 million(2), RBS recorded an operating loss of £2,303 million on a managed basis.

Total income increased by £1,816 million to £19,757 million primarily reflecting a lower accounting charge in relation to own credit adjustments; with expenses up 9% to £19,568 million. On a managed basis Group income, excluding the RCR impact of £333 million was down 10% to £19,775 million, principally reflecting a £1,161 million reduction in Markets income, with expenses down 4% to £13,313 million.

Retail & Commercial (R&C) operating profit was £2,693 million compared with £4,238 million in 2012. Excluding £1,385 million of impairments and other losses related to the creation of RCR, operating profit was down 4% to £4,078 million, with lower income in UK Corporate and International Banking offsetting improved impairments in Ulster Bank and UK Retail.

Markets operating profit was £620 million compared with £1,509 million in 2012. Excluding £18 million of impairments related to the creation of RCR, operating profit was down 58% to £638 million, reflecting its smaller balance sheet and reduced risk levels.

Non-Core losses were £5,527 million compared with £2,879 million in 2012. Excluding £3,420 million of impairments and other losses related to the creation of RCR, operating loss was down 27% to £2,107 million, with the cost base falling in line with run-off.

Loss attributable to shareholders was £8,995 million, reflecting the charges relating to the creation of RCR and legacy conduct litigation and redress, the write-down of goodwill and other intangible assets and deferred tax assets.

Notes:

(1) Includes the impact of business exits such as Citizens Financial Group and Williams & Glyn; bank levy; restructuring costs; and, from 2015, the EU resolution fund charge.

(2) During the year the Group recognised £4,823 million of impairment and other losses related to the establishment of RCR. This comprises impairment losses of £4,490 million (of which £173 million relate to core Ulster Bank assets which were not transferred to RCR but are subject to the same strategy) and £333 million reduction in income reflecting asset valuation adjustments.

2013 Financial Results

Delivering our capital plan

To deliver our capital plan RBS has formed the Capital Resolution Group (CRG), which is made up of four pillars: exiting the assets in RCR, delivering the IPOs for both Citizens and Williams & Glyn, and optimising the bank's group-wide shipping business.

RCR was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate run-down of these exposures to free up capital for the bank. The revised strategy to run down high risk loans faster led to an increased impairment charge. When originally announced, RCR assets were projected to be £38 billion at the end of 2013, but accelerated disposals and increased impairments have reduced this total to £29 billion. Further details about RCR are set out on page 158.

During the course of 2013 RBS sold two tranches of its remaining shares in Direct Line Insurance Group, realising gross proceeds of £1,137 million. At 31 December 2013, RBS held 28.5% of Direct Line Insurance Group. On 26 February 2014, RBS announced that it had entered into a placing agreement to complete the sale of its residual interest (except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to Direct Line Group management). Accordingly, on settlement of the placing, the Group will have completed the disposal as required by the European Commission.

On 27 November 2013, RBS announced the sale of its remaining economic interest in the WorldPay global payments business. A gain on sale of £159 million was recognised in Q4 2013.

On 1 November 2013, RBS announced plans to accelerate the divestment of Citizens, its US banking subsidiary. Preparations for a partial initial public offering (IPO) in 2014 remain on track, and the bank intends to fully divest the business by the end of 2016.

Following the conclusion of a £600 million pre- IPO investment by a consortium of investors led by global financial services specialists Corsair Capital and Centerbridge Partners, and including the Church Commissioners for England and RIT Capital Partners plc, the Williams & Glyn business (formerly known as "Project Rainbow") has made good progress towards its IPO.

Discussions with the UK Government over the retirement of the Dividend Access Share (DAS) are well advanced. A successful restructuring of the DAS will represent a significant step towards the normalisation of RBS's capital structure.

On 16 December 2013, RBS cancelled its £8 billion Contingent Capital Facility with HM Treasury.

Legacy conduct issues

As announced in a trading update on 27 January 2014, RBS has provided £1,910 million in Q4 2013 covering claims and conduct-related matters primarily relating to mortgage-backed and other securities litigation. Regulatory and litigation provisions for the full year amounted to £2,394 million.

An additional £465 million provision for Payment Protection Insurance (PPI) redress and related costs was booked in Q4 2013, making a total of £900 million for the full year 2013. Out of a cumulative PPI provision of £3.1 billion, £2.2 billion had been utilised by 31 December 2013. The remaining £0.9 billion provision covers approximately 12 months at current levels of redress and administrative expenses.

A further £500 million provision was made in Q4 2013 for interest rate hedging products redress and administration costs, reflecting higher volumes, higher anticipated redress payments and recalibration of our methodology based on more recent trends. The total charge for the full year was £550 million making a total of £1.25 billion of which £0.2 billion had been utilised by 31 December 2013.

Over time, with steady focus and disciplined delivery, the new RBS will emerge. The businesses we operate will be highly effective and relentless in their pursuit of delivering service that makes us number one for customers.

Serving our customers

Investment of £700 million has been committed over the next 3-5 years to build the best retail and commercial bank in the UK. Investment in digital channels continued, with 50% of eligible customers now banking online or on mobile.

Mortgage balance growth was affected in H1 2013 by advisor training, but application volumes recovered during the second half, helped by RBS's lead in launching the second phase of the Help to Buy scheme. Gross new lending in 2013 was £14.3 billion, up 3% from 2012. This represented an 8% market share, slightly in excess of RBS's share of mortgage stock.

UK Corporate will implement all the recommendations of the independent review of its lending standards and practices led by Sir Andrew Large.

Support for SME customers during 2013 included pro-active 'Statements of Appetite' sent to over 12,000 customers, resulting in more than £5.9 billion of new loan offers.

SME demand for credit has picked up over the course of the year, with new and increased lending sanctioned in 2013, up 6% from the prior year to £9.9 billion. SMEs drew down £6.4 billion of new loans in 2013, up 2% from 2012. However, businesses' cash generation remained strong, with SME current account balances up 13% from the end of 2012. Many customers increased their loan repayments and reduced overdraft utilisation, which dropped to 37% at the end of 2013 compared with 42% a year earlier.

Among larger businesses, £12.9 billion of new facilities were made available to new and existing clients. RBS also helped UK companies, universities and housing associations to raise £24.7 billion through bond issues in 2013.

RBS repaid all its borrowings from the Bank of England Funding for Lending Scheme (FLS) in 2013 but continues to participate fully in the scheme. In the period since launch to 31 December 2013, RBS allocated more than £4.7 billion of new FLS-related lending to business customers, with discounts targeted at SMEs and mid-sized manufacturers. We intend to remain in the scheme throughout 2014 (subject to no further changes in the scheme rules).

Total net lending flows reported within the scope of the FLS scheme were minus £2,295 million in Q4 2013, with net lending of plus £349 million to households and minus £2,645 million to private sector non-financial corporations, of which minus £671 million was to SMEs.

Our purpose and values

We are here to serve our customers. From the end of 2008 we have drastically changed as a business – our balance sheet has reduced by £1,191 billion, our capital ratios strengthened, our conduct and risk management framework overhauled. As a result, we are smaller, safer and stronger with a clearer focus. However, there was a clear need to unite the bank behind a single purpose and common set of values.

Our purpose:	Serve customers well.
Our vision:	We want to be trusted, respected and valued by our customers, shareholders and communities.

Our future is not about us, it is about our customers. We needed to ensure that this ran through the bank – from boardroom to branch. We spent time with colleagues across the bank debating what should be at the core of our ambition to build a bank known for its consistent, high quality customer service. We agreed on a single, simple purpose – to serve customers well. We want to be trusted, respected and valued by our customers, shareholders and communities. To do this we have put a common set of values at the heart of how we do business. Our values are not new, but capture what we do when we are at our best.

Our values:
Serving customers
We exist to serve customers.
We earn their trust by focusing on their needs and delivering excellent service.

Working together
We care for each other and work best as one team.
We bring the best of ourselves to work and support one another to realise our potential.

Doing the right thing
We do the right thing.
We take risk seriously and manage it prudently.
We prize fairness and diversity and exercise judgement with thought and integrity.

Thinking long term
We know we succeed only when our customers and communities succeed.
We do business in an open, direct and sustainable way.

All this comes together in Our Code.

Our purpose and values

We have a programme of change in place that embeds a working culture which celebrates challenge when business decisions or behaviours are not in line with our values. We have engaged our employees to stimulate ideas and change that ultimately results in material improvements to the customer experience.

At the beginning of 2013, a personalised letter launching the new purpose and values was signed by the members of our Executive Committee and sent to all of our employees. Employees were invited to engage in an open debate online to discuss the new values – 25,000 joined that conversation.

Regional leadership workshops were designed to build understanding and engagement for more than 3,000 of our leaders. Those leaders then engaged locally to help their people understand how the purpose and values were relevant to their business area. By September, 66% of staff had been involved in a conversation with their leader, and 93% of those have a better understanding of the relevance to their part of the business.

We made fundamental, lasting changes to the way we do business by re-writing our code of conduct and policy framework. Our Code was an important milestone in our focus on the customer and our values. Our Code included a new decision making tool – the YES Check.

It is a simple guide to help employees check whether they are making the right decision in line with our purpose and values. Mapped back to regulatory principles, the YES Check was another important recognition that the decisions we take everyday impact our customers and our communities.

We have continued to professionalise our customer facing staff, committing to accredit them against professional standards by the end of 2014.

We also changed the way we recognise the best behaviours in the bank. We launched Our Values Awards for all our employees and nominations were submitted of examples where people were living the values and serving customers well.

New Leadership Standards were developed to align them directly with our values. These standards support Our Code and provide us with a clear view of what is expected from leaders and is being built into how we recruit, develop and reward them.

We have made progress but we need to continue to have a rigorous focus on how to serve customers well, and work to fully embed our values in everything we do. Our employees believe in the goals of RBS and already 1 in 2 people have seen a change in how their team works.

Our business model and strategy

The RBS business model is that of a UK-focused retail and commercial bank. Our market leading customer franchises in the UK serving personal, business and corporate customers in the RBS strategy. Our wholesale banking operations in the corporate and institutional business enhance and complement the proposition to our commercial customers.

Our major source of income in our retail and commercial banking businesses is net interest income. This is the difference between the income we earn from the loans and advances we have made to our personal, corporate and institutional customers and on our surplus funds and the interest we pay on deposits placed with us by our customers and our debt securities we have issued. We also earn fees from financial services and other products we provide to our customers as well as rental income from assets we lease to our customers.

Our Markets business earns income from client driven trading activities particularly Rates, Currencies, Asset-Backed Products and Credit.

Our leading customer franchises serve 24 million customers globally, of which more than 70% are in the UK. We aim to provide them with a comprehensive range of products, delivered through a number of channels, which are increasingly digital.

We do business in competitive markets but we have strong franchises and good growth opportunities, and we aim to target our investment to maximise these opportunities.

Over the period 2009-2013, the RBS strategic approach has focused first and foremost on rebuilding financial resilience:

- reducing total assets, principally through the run-off of the Non-Core;
- reducing risk concentrations;
- reducing dependence on short-term wholesale funding while achieving a deposit-led funding model; and
- reducing balance sheet leverage.

This emphasis was necessary in order to correct historical weaknesses and to set RBS on a sound footing, but it left us falling short in our ability to build long-term shareholder value on the foundation of serving our customers and meeting more of their financial needs.

In 2013 we have refocused our Markets and International Banking businesses to deliver a targeted wholesale banking proposition to UK corporates and global financial institutions.

Strategic review
On 1 November 2013 RBS announced a full review of its customer-facing businesses, its IT and operations, and its organisational and decision-making structures. As a result of this review, we have announced a refreshed strategic direction with the ambition of building a bank that earns its customers' trust by serving them better than any other bank.

Business structure
RBS will be structured to deliver this ambition by organising itself around the needs of its customers, so as to combine customer groups with similar needs into business units able to deliver co-ordinated services. The seven existing operating divisions will be realigned into three businesses:

- Personal & Business Banking will serve UK personal and affluent customers together with small businesses (generally reporting up to £2 million turnover), with more business bankers moving back into branches.

- Commercial & Private Banking will serve commercial and mid-corporate customers and high net worth individuals, deepening relationships with commercial clients operating overseas through its market leading trade and foreign exchange services, while connecting our private banking brands more effectively to successful business owners and entrepreneurs.

Our business model and strategy

	Personal & Business Banking	Commercial & Private Banking	Corporate & Institutional Banking
CEO	Les Matheson	Alison Rose	Donald Workman
RWAs profile (%)(1)	~35%	~30%	~35%
Operating profit profile (%)(1)	~50%	~30%	~20%
Target RoE(1)	15%+	15%+	~10%(2)

Notes:
(1) All business targets refer to steady state performance 2018 - 2020.
(2) 7-8% medium-term.
(3) This table contains forecasts with significant contingencies. Please refer to "Forward Looking Statements" and "Risk Factors".

Corporate & Institutional Banking will serve our corporate and institutional clients primarily in the UK and Western Europe, as well as those US and Asian multinationals with substantial trade and investment links in the region, with debt financing, risk management and trade services, focusing on core product capabilities that are of most relevance to our clients.

Ulster Bank in Northern Ireland will benefit from a closer integration with our personal, business and commercial franchises in Great Britain, while continuing to operate under the Ulster Bank brand. We are continuing to review our business in the Republic of Ireland with a view to being a challenger to the systemic banks in Ireland.

The reorganised bank will be a UK-focused retail and corporate bank with an international footprint to drive its corporate business. It will be managed as one bank, with one strategy.

Each of the three businesses is built on franchises that have the potential to be the number one bank for their respective customer groups. Each is designed to:
- Serve customer needs better than the existing operating divisions.
- Help eliminate duplication of costs in front and back offices.
- Position RBS to deliver a sustainable overall return on tangible equity of 12% plus in the long term.

A more detailed review of component business lines continues within each business, and further updates will be provided over the course of the year.

Addressing costs and returns
Key to achieving this is a significant reduction in RBS's costs and complexity. Transforming the bank to deliver this involves rationalising and simplifying systems, based on a target architecture with improved resilience.

Examples of these measures include:
- The number of technology platforms we use will be reduced by over 50%.

- We will move from 50 core banking systems to around 10.

- From 80 payment systems currently maintained we will move to approximately 10.
- Our property portfolio will be reduced from 25 million square feet to 18 million square feet, including significant reductions in central London.
- We will maintain a similar level of investment spending but directed at customer facing process improvements, instead of maintaining inefficient legacy infrastructure.

This simplification is intended to deliver significant improvements to services delivered to our customers but at the same time serves as the cornerstone of a programme designed to bring our cost base down from £13.3 billion in 2013 to £8 billion in the medium term, including the impact of business exits such as Citizens Financial Group and Williams & Glyn, the bank levy, restructuring costs and, from 2015, the EU resolution fund charge. This plan will take RBS towards a cost:income ratio of around 55%, moving towards 50% in the longer term. Bringing our cost base back into alignment with the reduced scale of our business underpins our potential to deliver improved returns in future years.

The costs to achieve this plan will total approximately £5 billion over 2014 to 2017; of this approximately £1 billion has already been committed to previous plans related primarily to Citizens, Williams & Glyn and the previous restructuring announced for Markets. Approximately £0.6 billion relates to the costs of achieving asset reductions and realisations in Markets as we reshape this business over the next three to five years.

Our business model and strategy

	Measure	2013	Medium term	Long term
Customer	Service(1) Trust	<25% of businesses at #1		All businesses at #1 #1 trusted bank in the UK
People	Great place to work			Engagement index ≥ Global Financial Services norm (2)
Efficiency	Cost:income ratio Costs	73%(3) £13.3 billion	~55%(3) ~£8 billion(3)	~50%(3)
Returns	Return on tangible equity(4)	Negative	~9-11%	12%+
Capital strength	Common Equity Tier 1 ratio(5) Leverage ratio(5)	8.6% 3.5%	≥12% 3.5-4%	≥12% ≥4%

Notes:
(1) Measured by Net Promoter Score, with the exception of Corporate & Institutional Banking, which will use customer satisfaction. NPS nets the percentage of "promoters" (loyal enthusiasts of the company) and the percentage of "detractors" (unhappy customers) to give a measure of customer advocacy.
(2) Global Financial Services norm currently stands at 82%.
(3) Including bank levy, restructuring charges and, from 2015, the EU resolution fund charge.
(4) Calculated with tangible equity based on CET1 ratio of 12%.
(5) Fully loaded Basel III.
(6) This table contains forecasts with significant contingencies. Please refer to "Forward Looking Statements" and "Risk Factors".

Delivery of 2009-2013 Strategic Plan
In 2009 RBS set out a five year strategic plan aimed at restoring RBS to standalone strength.
The plan was built on four business objectives:
- To base RBS on enduring customer franchises, with each business capable of generating a sustainable return in excess of its cost of capital
- To deliver the RBS strategy from a stable risk profile and balance sheet, with each banking business self-funding (100% loan:deposit ratio)
- To deliver an attractive blend of profitability, stability and sustainable growth from the chosen business mix

Management hallmarks to include an open, investor-friendly approach; discipline and proven execution effectiveness; strong risk management; and central focus on serving our customers well.

We set out key measures and have consistently reported on our progress against these over the course of the five year plan. Progress against the risk measures has been strong, with all targets exceeded, in some cases by very large margins. Progress against value drivers, however, has not lived up to our expectations at the time the plan was established, with deterioration in both return on equity and cost:income ratio.

RBS at a glance

"We must become a company that knows what it means to obsess about our customers. This is a fundamental challenge that will involve the whole organisation."

RBS is rooted in the UK, serving personal, business and institutional customers in the UK and many other countries. Our businesses are strong players in the markets in which we choose to compete. The businesses are stronger together than apart, to the benefit of customers and shareholders.

RBS is now safer and the day when we will be able to offer shareholders a decent return is closer. But making RBS a really good bank demands more. That is why we are still investing more effort in all of our businesses to serve customers well.

RBS at a glance

UK Retail

Customer story

Mobile nation
With over one billion logins since its launch, the RBS mobile banking app helps customers access their money while on the move.

Over £30 million transferred every day
At the swipe of a smartphone customers can check their balance, move money, view their transaction history, pay a contact or even take cash out without a debit card. With over £30 million transferred every day, it's actually the bank's busiest branch: over a 30 day period, we had around 78 million logins which is equal to each customer visiting a physical branch around 30 times a month.

By contrast, people tend to visit an actual branch less than once a month.

Performance highlights	2013	2012
Return on equity (%)	26.3	24.4
Cost:income ratio (%)	54	51
Loan:deposit ratio (%)	97	97
Risk-weighted assets (£bn)	43.9	44.8

We offer a comprehensive range of banking products and related financial services to the personal market. We serve customers through the RBS and NatWest networks of branches and ATMs, and also through telephone and digital channels.

Performance overview
- Operating profit increased 3% from £1,891 million to £1,943 million, driven by a decline in impairment losses.
- Mortgage balance growth was affected in H1 2013 by advisor training but recovered during H2 2013.
- Customer deposits increased by 7%, above UK market average.
- Net interest margin held steady, despite tightening margins on new mortgages. Lower income was earned on current account balances, but savings margins improved.

Building a better bank that serves customers well
In March 2013 UK Retail announced its strategy to become a simpler and more customer focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Investment in digital channels continued, with half of all eligible customers now banking online or on mobile. Although branch counter transactions have fallen 30% since 2010 a programme to refurbish our branches has begun.

RBS at a glance

UK Corporate

Chris Sullivan
Chief Executive

Customer story
Stormy weather
The UK suffered from terrible weather at the end of 2013, which caused serious damage and destruction. Adverse weather can have a dramatic effect on a business – loss of property and stock, failing systems, supply chain failures and halted trading – pushing them into financial difficulty, impacting employees and local communities. To help ease the pressure for businesses who have been directly or indirectly affected, we launched a £250 million UK Storm Business Fund. Interest-free loans can be provided for three months to viable and eligible businesses, whether or not they are existing customers (maximum of £250k per loan). Short-term, interest-free financing can be provided to cover, for example, cost of repairs and replacement stock while businesses wait for insurance claims to be paid.

Performance highlights	2013	2012
Return on equity (%)	7.9	14.5
Cost:income ratio (%)	50	44
Loan:deposit ratio (%)	80	82
Risk-weighted assets (£bn)	86.1	86.3

We are a leading provider of banking, finance and risk management services to the corporate and SME (small and medium-sized enterprise) sector in the United Kingdom. We offer a full range of banking products and related financial services.

Performance overview
- Operating profit was down 41% at £1,060 million. Excluding £410 million impairments related to the creation of RCR, operating profit was down 18%.
- Impairments included an additional £410 million related to the creation of RCR. Excluding this, impairments were 7% lower than in 2012.
- Excluding the impact of increased impairment losses related to the creation of RCR, return on equity was 11%.
- Net interest income fell in a lower interest rate environment.
- Continued run-off of property and shipping outweighed growth in other sectors, leaving loan balances down 5%.

Building a better bank that serves customers well
To reinforce its commitment to supporting the UK economy, RBS appointed Sir Andrew Large to lead an independent review of its lending standards and practices. UK Corporate has undertaken to implement all the Independent Lending Review's recommendations and is adopting a revised strategy to accomplish this. Support for SME customers included proactive "Statements of Appetite" sent to over 12,000 customers, resulting in approximately £6 billion of new loan offers.

RBS at a glance

Wealth

Rory Tapner
Chief Executive

Customer story
Network connection
Every entrepreneur knows the power of networking to build connections and contacts. Taking that network to the next level takes time and effort, things which are often in short supply.

Coutts were able to bring the right people to the table

However, Coutts' focus on adding value to every relationship can also help bring the right people together. When one client was looking to diversify into renewables and food security in the Middle East, Coutts were able to bring the right people to the table, providing a catalyst for the client's growth opportunities and showing the value of our inter-connected world.

Performance highlights	2013	2012
Return on equity (%)	12.0	13.1
Cost:income ratio (%)	77	75
Loan:deposit ratio (%)	45	44
Risk-weighted assets (£bn)	12.0	12.3

We provide private banking and investment services in the UK through Coutts & Co and Adam & Company; offshore banking through RBS International, NatWest Offshore and Isle of Man Bank; and international private banking through Coutts & Co Ltd.

Performance overview
- Operating profit was 9% lower at £221 million.
- Income was 7% lower, with net interest income declining over the year, reflecting tighter deposit spreads. Deposit margins improved in the fourth quarter following a repricing initiative.
- Assets under management rose 3%, but total client assets and liabilities managed by the division declined by 2% following the repricing initiative.
- Expenses were 4% lower, partly reflecting reduced headcount and tight discretionary cost management.

Building a better bank that serves customers well
2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review. Clients welcomed Coutts' new fully compliant advice led model, where advisers must achieve the more stringent Level 6 rating, in excess of the Level 4 minimum required by the Financial Conduct Authority. Work continued to streamline client-facing processes and drive increased technology benefits.

RBS at a glance

International Banking

John Owen
Chief Executive

Customer story
Straight ahead
TomTom's navigation and location systems are used by customers in over 35 countries. To comply with finance regulations, they had to implement a standard format for payments across the Single Euro Payments Area.

Used by customers in over 35 countries

They also wanted to use this as an opportunity to make payments more efficient and reduce risk. They worked closely with RBS to make a number of changes to their internal processes and thanks to meticulous planning and communication, the changes were successful. TomTom now has one, single payment process for suppliers across the world.

Performance highlights	2013	2012
Return on equity (%)	3.9	9.1
Cost:income ratio (%)	73	66
Loan:deposit ratio (%)	91	91
Risk-weighted assets (£bn)	49.0	51.9

We offer a core banking proposition to multinational corporates and financial institutions by providing debt financing, risk management and transaction services. We work with clients to find the best product mix to execute their strategy.

Performance overview
- Operating profit decreased by 53% to £279 million, with cash management income depressed by the decline in LIBOR interest rates. Excluding impairments of £52 million related to the creation of RCR, operating profit was down 44%.
- Expenses were reduced by 5%, as International Banking kept costs under tight control and achieved timely run-off of discontinued businesses.
- Customer deposits declined by 15% in line with a change in Group funding strategy.

Building a better bank that serves customers well
With business conditions still challenging as themes of low interest rates and margin compression continue, International Banking remained focused on cost discipline throughout 2013. The division continued to strengthen its balance sheet, reducing risk-weighted assets by 6%, despite the introduction of more severe credit risk models. RBS received a number of awards for trade finance and cash management services.

RBS at a glance

Ulster Bank

Jim Brown
Chief Executive

Customer story
Home run
Demand for affordable housing is extremely high across the UK and Apex, one of Northern Ireland's largest housing associations, is working hard to help meet this need. Apex employs 570 people and has over 4,000 units under management, including general needs housing, supported housing, sheltered housing and registered care.

1,000 brand-new social and affordable homes

A £10 million loan from Ulster Bank will help Apex deliver around 1,000 brand new social and affordable homes, creating much-needed new homes as well as hundreds of construction jobs.

Performance highlights	2013	2012
Return on equity (%)	(32.4)	(21.8)
Cost:income ratio (%)	64	62
Loan:deposit ratio (%)	120	130
Risk-weighted assets (£bn)	30.7	36.1

We are a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. We provide a comprehensive range of financial services through our Retail Markets and Corporate Markets divisions.

Performance overview
- Operating loss for 2013 was £1,457 million, including increased impairment losses of £892 million relating to the creation of RCR. Excluding the impact of the creation of RCR, operating loss improved by £494 million or 48%.
- Impairment losses improved significantly, excluding the RCR impact, with a 64% reduction in losses in the mortgage portfolio.
- Retail and SME deposit balances increased by 2%, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.

Building a better bank that serves customers well
The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers.

RBS at a glance

US Retail & Commercial

Bruce Van Saun
Chief Executive, RBS Citizens and
Head of RBS Americas

Customer story
System success
The system helped create a much better customer experience. Cheques and documents can now be scanned at the teller window, with transactions being balanced there and then in front of the customer. That means fewer errors and corrections as well as helping to reduce fraud.

Helped create a much better customer experience

BIC supports our goal of becoming our customers' primary banking partner through greater convenience, more privacy and fewer errors. Now we have a truly functional tool that delivers efficiency and security for our customers.

Performance highlights	2013	2012
Return on equity (%)	7.2	8.9
Cost:income ratio (%)	73	71
Loan:deposit ratio (%)	91	86
Risk-weighted assets (£bn)	56.1	56.5

We provide financial services primarily in the Northeastern, Mid-Atlantic and Midwest United States through the Citizens Bank, Charter One and RBS Citizens brands. We are engaged in retail and corporate banking activities.

Performance overview
- Operating profit of $1,012 million was down 15%, with low short-term interest rates continuing to limit net interest margin expansion while rising long-term rates slowed mortgage refinance volumes.
- Average loans and advances were flat, with commercial loan growth of 5% partly offset by run-off of long-term fixed rate consumer products.
- Impairment losses increased by $99 million to $244 million.

Building a better bank that serves customers well
On 1 November 2013 RBS announced plans to accelerate the initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. It is expected that by the end of 2016 RBSCFG will be a standalone regional bank, wholly owned by public shareholders. RBSCFG commenced a number of actions in 2013 aimed at improving financial performance, driving profitable growth by focusing on the customer and delivering a differentiated experience.

RBS at a glance

Markets

Peter Neilson Co-CEO

Suneel Kamlani Co-CEO

Customer story
Weighing anchor
Peel Ports Group, one of the UK's biggest port operators, handles over 65 million tonnes of cargo a year. An RBS backed refinancing programme has enabled the development of Liverpool2, the new deep sea container terminal in the Port of Liverpool, costing in excess of £300 million.

The benefit of this investment is hugely positive.

As one of their most important sites, this investment in growth will assist the UK's shipping industry to remain globally competitive as well as acting as a catalyst for future development. It's believed Liverpool2 will help create around 5,000 jobs in Merseyside, including additional apprenticeships – a great boost for the local economy.

Performance highlights	2013	2012
Return on equity (%)	5.0	9.6
Cost:income ratio (%)	79	66
Risk-weighted assets (£bn)	64.5	101.3

We provide financing, risk management and advisory services to RBS corporate and institutional clients.

Performance overview
- Operating profit fell by £889 million, 59% to £620 million with income falling by 26%, partly offset by significant cost reductions. The de-risking of Markets resulted in a 36% reduction in risk-weighted assets.
- Currencies income increased but returns from the Rates business were subdued.
- Costs fell by 11%, reflecting a reduction in headcount of 1,000 evenly split between front and back office – and tightly controlled discretionary expenses.
- Third party assets were reduced by £72 billion (down 25%) and risk-weighted assets by £37 billion (down 36%).

Building a better bank that serves customers well
In 2013, Markets launched and executed a strategy aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths. The division met or exceeded all internal targets for reducing controllable costs, risk-weighted assets and the balance sheet, while meeting revenue and income expectations. Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment with client activity limited by uncertainty over monetary policy in the US.

RBS at a glance

Non-Core

Rory Cullinan
Chief Executive

Established in 2009 as the principal vehicle of risk reduction. At inception it had £258 billion of Third party assets and £171 billion of risk weighted assets. Non-Core reduced these assets in a capital efficient manner and at a pace the bank could afford.

Performance overview
- Third party assets declined by £29 billion, or 51% reflecting run-off, disposals and impairments.
- Risk-weighted assets were down £31 billion, driven by disposals and run-off.
- Operating loss of £5,527 million was £2,648 million higher than in 2012, predominantly due to £3,118 million of 2013 impairments related to the creation of RCR.

Building a better bank that serves customers well
Non-Core has successfully achieved and surpassed its five year strategic plan target set in 2009, reducing third party assets by 89% from an initial £258 billion. By the end of 2013 Non-Core represented c.4% of RBS's funded balance sheet, compared with 21% when the division was created. While the new RCR is similar in size to Non-Core, the assets have been selected on a different criteria and are not directly comparable.

Business Services

Simon McNamara
Group Chief Administrative Officer

In Business Services we keep RBS running, supporting our customers 24 hours a day, 365 days a year. We put money in the ATMs, keep the bank's technology systems operating, help to keep our customers safe from fraud, process billions of pounds worth of payments across the world, and provide call centre and online services to customers.

We work across four business areas: Technology Services, Group Operations, Corporate Services and Strategy & Architecture. Together we connect colleagues and customers, providing the tools and services that help us to serve our customers when and where they need us.

- We issued two million time-saving contactless cards in 2013 allowing customers to make quick and easy payments for everyday items under £20 in less than a second.

- Through our Simplifying Customer Life initiative 4,500 ideas have been submitted improving over four million customer interactions each year.

- We have delivered almost 50 Cyber Crime and Fraud Prevention seminars to more than 2,500 RBS customers, non-customers and RBS Relationship Managers worldwide.

- Over two million customers log on to online or mobile banking every day.

- Since 2010, when we launched our mobile app, we have had more than a billion log-ons.
- Our energy initiatives have resulted in an 18% reduction in energy consumption in our flagship buildings during 2013.
- We introduced a funds transfer option on our ATMs, which allows customers to move funds between their accounts.
- IT incidents in recent years have caused inconvenience to our customers. To reduce the impact of any technology outages on our customers, we are investing over £750 million in a three-year period to improve the resilience of our systems, becoming safer and more secure.

Governance at a glance

Board and committee activity increased significantly in 2013, with a number of key strategic issues taking centre stage, and Board committees continued to play a crucial role in our governance framework, undertaking their complex work comprehensively and effectively supporting the work of the Board.

Conduct and culture have been key areas of focus throughout the year and our 2013 results reflect the impact that conduct related matters continue to have on financial and operating performance. The Board fully supports our new values, which were launched in 2013 and focus on serving customers, working together, doing the right thing and thinking long term. It is vital that the Board continues to set the tone from the top to drive essential cultural change and that our governance framework continues to evolve to support this and our key strategic changes. These will be key priorities for the Board and its Committees in 2014.

Philip Hampton
Chairman of the Board of directors

Our Board
The Board has 11 directors comprising the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director. Biographies for each director and details of which Board Committees they are members of can be found in the Corporate governance report on pages 42 to 45.

There were a number of changes to the Board's composition during 2013, details of which can be found in the Chairman's Statement on pages 24 and 25 and in the Corporate governance report on page 48.

The Board is the main decision-making forum for the company. It is collectively responsible for the long-term success of the company and is accountable to shareholders for financial and operational performance.

The Board has overall responsibility for the following areas:

- the establishment of strategy and consideration of strategic challenges;
- the management of the business and affairs of the Group;
- ensuring that risk is managed effectively through the approval and monitoring of risk appetite;
- considering stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations;
- the allocation and raising of capital; and
- the preparation and approval of the RBS annual report and accounts.

We conducted an internal evaluation of the effectiveness of the Board and its committees in 2013, led by the Group Secretary. The evaluation has concluded that the Board is operating effectively but has identified some areas for improvement which we will focus on during 2014.

Our Board committees
Group Audit Committee

Assists the Board in discharging its responsibilities for monitoring the integrity of the financial statements of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group and the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit.

For more detail of the operation of the committee please refer to the full committee report on pages 55 to 60.

Board Risk Committee
Provides oversight and advice to the Board on current and potential future risk exposures of the Group and risk strategy. It reviews the Group's compliance with approved risk appetite and oversees the operation of the Group Policy Framework.

For more detail of the operation of the committee please refer to the full committee report on pages 61 to 66.

Group Performance and Remuneration Committee
Responsible for overseeing performance and the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on the remuneration of executive directors.

For more detail of the operation of the committee please refer to the full committee report on pages 69 to 93.

Governance at a glance

Board of directors and Executive Committee

Board

Chairman	Executive directors	Non-executive directors
Philip Hampton	Ross McEwan	Sandy Crombie
	Nathan Bostock	Alison Davis
		Tony Di Iorio
		Robert Gillespie
		Penny Hughes
		Brendan Nelson
		Baroness Noakes
		Philip Scott

Secretary and Head of Corporate Governance
Aileen Taylor

Executive Committee*

Ross McEwan	Group Chief Executive
Nathan Bostock	Group Finance Director
Rory Cullinan	Chief Executive, RBS Capital Resolution Group
Suneel Kamlani	Co-Chief Executive, Markets
Les Matheson	Chief Executive, UK Retail
Simon McNamara	Group Chief Administration Officer
Jon Pain	Group Head of Conduct & Regulatory Affairs
David Stephen	Group Chief Risk Officer
Chris Sullivan	Chief Executive, Corporate Banking
Bruce Van Saun	Chief Executive, RBS Citizens Financial Group, Inc and Head of RBS Americas

* As at the date of signing of the Annual Report and Accounts.

Group Nominations Committee

Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

For more detail of the operation of the committee please refer to the full committee report on pages 53 and 54.

Group Sustainability Committee

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.

For more detail of the operation of the committee please refer to the full committee report on pages 67 and 68.

Executive Committee
Supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations and considers risk strategy, policy and management.

RBS Capital Resolution (RCR) Board Oversight Committee
Provides oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

UK Corporate Governance Code
This is the first year that we are reporting under the new narrative reporting requirements which include the new Strategic Report and changes in remuneration reporting. Throughout the year ended 31 December 2013, the company has complied with all of the provisions of the UK Corporate Governance Code except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. The company considers that this is a matter which should rightly be reserved for the Board. Our statement of compliance with the UK Corporate Governance Code (the "Code") is set out on page 96.

Chairman’s statement

Chairman’s statement

Philip Hampton
Chairman

“We are confident that the actions announced will deliver a customer focused bank.”

Five years ago RBS embarked on a strategic restructuring designed to correct the aspects of its business that made it particularly vulnerable to the financial crisis of 2008. The execution of that restructuring has transformed the financial position of the bank: we have reduced our balance sheet by more than £1 trillion, repaid hundreds of billions of Government funding support and removed the imminent threat that our size, risk and complexity posed to the UK economy. In 2013 we took further steps to resolve our remaining legacy balance sheet issues by announcing the creation of RCR, with the aim of accelerating the removal of these legacy assets and releasing the capital they are still tying up.

We have also taken very substantial charges for a variety of conduct-related issues, including LIBOR, PPI, interest rate swaps and RMBS litigation. Almost all of these costs for RCR and conduct issues can properly be described as legacy costs, arising from events and actions in the run-up to the financial crisis.

As our 2013 results make clear, however, restoring the strength of the bank’s balance sheet was only one part of the job. In June the Board announced that Stephen Hester, who had led our financial restructuring since 2008 very effectively, would be stepping down as Group Chief Executive. We selected Ross McEwan to re-energise the task of building a bank that earns its customers’ trust, improves operating efficiency and can move down the path back to full private ownership. The Board and I want to thank Stephen Hester for his dedication to RBS and to congratulate him on his success in putting the bank on to a sound footing.

There have been a number of other changes to the Board’s composition during the year. Bruce Van Saun took up his new role as Chairman and Chief Executive of RBS Citizens Financial Group, Inc. on 1 October 2013 and has stepped down from the Board having done an excellent job as our Group Finance Director. He was succeeded by Nathan Bostock, who has since confirmed his resignation; his leaving date has not yet been agreed and the search for his replacement is under way.

Two of our non-executive directors, Joe MacHale and Art Ryan, also retired from the Board in 2013 and Philip Scott will step down from the Board by 31 October 2014. I thank them all for the hard work and wisdom they have brought as directors. In December 2013, we also welcomed Robert Gillespie as a new non-executive director. I would like to take this opportunity to express my appreciation to all of my fellow directors for their commitment and readiness to deal with the unusual challenges of a government-controlled listed company.

Ross McEwan is bringing a fresh perspective to RBS’s challenges, and that perspective is now bearing fruit in the results of the strategic review that we are setting out. The Board believes that this was the right time for this review, so as to ensure that we target our future efforts firmly towards serving our customers, shareholders and wider stakeholders in the best possible way.

Regrettably, last year brought further reminders that many of our customers and stakeholders do not trust us to do so. In response to persistent criticism of our performance in lending to SMEs the Board commissioned an independent review by Sir Andrew Large; we expect to adopt all of his recommendations.

Chairman's statement

We also faced accusations that our Global Restructuring Group had been culpable of "systematic and institutional" behaviour in artificially distressing otherwise viable businesses. No evidence has been provided for that allegation but it has, nevertheless, done serious damage to RBS's reputation. That is why we instructed the law firm Clifford Chance to conduct an independent review. This is an area where all banks routinely make difficult judgments, and indeed the banking sector has been criticised for excessive forbearance in recent years, charged with supporting unviable "zombie" companies for too long.

Issues like this continue to underscore the important role played by culture and values in enabling us to become the trusted bank we aspire to be. The Board fully supports the new values we launched in 2013, and it is vital that we continue to set the tone from the top in the coming year to drive essential cultural change.

On many of these issues we have engaged closely with HM Treasury (HMT) through UK Financial Investments, which manages HMT's shareholding, and with our two main regulators, the Prudential Regulation Authority and the Financial Conduct Authority. Over the course of the year they have all proposed actions for consideration by the Board.

Ross McEwan has spoken of the need to reset our relationship with HMT and our main regulators. I hope and believe that we have made good progress in this direction. There is a desire on all sides that our relationship with the Government in its role as controlling shareholder should be primarily managed by UKFI on a commercial, arm's length basis. I want to make it clear, however, that the path we have set and decisions we have taken reflect the Board's view of what is in the interests of all RBS's shareholders and other stakeholders.

We are monitoring the debate on Scottish independence but, as I and my colleagues have said many times, we are politically neutral. We don't support political parties or political movements. We will respond to whatever voters decide and governments agree.

Clearly there are issues we are looking at – currency, the application of financial regulation, lender of last resort, credit ratings – which could affect us. But there is real uncertainty about how any of these matters would be settled in the event of a Yes vote and the outcome would depend on negotiations between the two governments. Indeed, there could be a prolonged period of uncertainty over each of the issues so it really is impossible to quantify with any precision what the effects of each might be right now.

We are confident that the actions announced will deliver a customer-focused bank with undoubted capital strength, the potential for attractive returns and an ability to recommence dividends over the medium term.

Philip Hampton
Chairman
26 February 2014

Chief Executive’s review

Ross McEwan
Chief Executive

“Our focus will be determined by where our customers need us, and where we can serve their needs better than anyone else.”

Since 2009 RBS has cleaned up the world’s largest bank balance sheet by removing more than £1 trillion in assets. This was a remarkable achievement, born of absolute necessity, but delivered with exceptional skill.

These skills now need to be deployed on a task of equal magnitude: creating a step-change in the customer service and financial performance of RBS. The hardest part of our financial restructuring is now complete, and we now need to use our strengths and capabilities to make RBS an example for everything that should be right with banking.

Since taking up post in October, I have listened extensively to our customers and our staff. It is clear to me that people have not given up on us. Our customers tell me we have good people with good intentions. But they also tell me they are frustrated by the way we work.

The potential for RBS is tangible, we have points of brilliance, but these are masked by a heavily damaged reputation, very high cost base and a structure that reflects the bank we are leaving behind, not the one we will become.

We hold many excellent market leading positions across the bank and, despite the distractions of our recovery, there are areas where we have started to excel for our customers. But this remains an inconsistent picture and the returns in our strongest businesses can often be diluted by weaker parts of the franchise, the price of past misconduct and an uncompetitive cost base.

We are clear on our purpose as a bank: to serve customers well, but we are yet to operate in a way that means we can really deliver on this. Delivering on our purpose will mean running the bank differently.

To meet more of our customers’ needs we must earn more of their trust. This starts with improving the things that matter most to customers, and then rewarding their loyalty. There are too few rewards for customer loyalty in banking and we need to change this. Loyal and rewarded customers are the basis for the higher quality earnings we intend to deliver.

Change won’t happen overnight, but we are clear where we can improve and our progress will be evident quarter-by-quarter. We have already started calling out the barriers to our ambition.

Chief Executive's review

The opportunity cost of our current approach is clear. We have an 18% share of the GB main current account market but less than half our customers have a mortgage with us. The same is true in different forms across all our businesses and paints a clear picture of untapped potential. I know this frustrates our people, all of whom want to prove the worth of this bank through better service to customers.

The lack of connectivity for customers is a by-product of our own complexity. Too many customers are forced to bank around us; adapting their behaviour to fit with our processes. It's frustrating for them and value destructive for us.

Our customers rightly demand that we are competitive, in every setting and in every sector. We currently carry the cost base of a global financial services group when in fact we are increasingly a UK–based bank. Our operating model means our customers and shareholders end up paying for parts of the business that cost too much and deliver too little in their interests.

This needs to change.

RBS needs a strategy that will address the weakness in our performance for customers, so that we can provide acceptable returns to our shareholders. The business review I have conducted has revealed our key challenges, but it has also given us a clear path to improve the bank.

On every dimension our opportunity to improve the relative and absolute performance of the bank is significant. It is my job to make sure our strategy for customers translates into value for our shareholders.

2013 FINANCIAL PERFORMANCE

This bank has had an extraordinary five years. Cleaning up a £2.2 trillion balance sheet whilst addressing the many failings of the past has carried a very heavy cost, which shows in our results.

Even by recent standards, 2013 was a difficult year. Regulatory fines, wide-ranging customer complaints, technology problems and public questioning of our integrity all weighed heavily, and bring into sharp focus the job we have at hand.

For the full year, we reported a pre-tax loss of £8.2 billion. The loss includes £3.8 billion of legacy litigation, conduct and regulatory costs and £4.8 billion of impairments and other losses relating to the establishment of RBS Capital Resolution (RCR).

Looking at underlying performance, total income was down £2.3 billion for the year, primarily reflecting lower revenues from the re-sized Markets business while costs were only down £0.5 billion – pushing the cost:income ratio towards the worse end of our peer group at 67%.

Returns varied across our businesses, but only UK Retail and Wealth delivered returns above the cost of equity. That said, the bank continued to make progress despite our financial performance.

Our business milestones included completing the run-down of another £29 billion of Non-Core assets - ahead of plan and taking the total reduction since Non-Core was established to £230 billion - setting up the RCR unit and reducing risk-weighted assets, and hence our risk profile, by £66 billion, on a fully loaded Basel III basis.

We also cancelled the £8 billion Contingent Capital Facility with HM Treasury, reduced our stake in Direct Line Group to 28.5% - in line with our commitment to the EC - and we are in advanced discussions to restructure the

Dividend Access share.

It is clear that the underlying performance over the last year underlines the need for us to shift the emphasis from restoring the balance sheet to recharging our performance.

WHY WE MUST CHANGE

Capital: The capital plan we announced in November outlined a number of concrete actions to place the bank on a sure footing. Among them, the creation of RCR and the flotation of Citizens Financial Group will allow us to target a Common Equity Tier 1 capital position of 12% or greater by the end of 2016.

The capital plan has been designed to allow us to focus without distraction on improving our operating performance.

We will do what it takes to reach and maintain a prudent capital position.

Cost and Complexity: There was a necessary complexity to running an organisation with a £2.2 trillion balance sheet, as ours was five years ago, but this need has reduced as we have scaled the bank dramatically down over recent years. We now need to simplify our structure and cost base to match.

Chief Executive's review

RBS remains a complex bank. We can be hard to do business with, costly to operate, and complicated to work in. We have seven customer-facing divisions as well as RCR and central functions, many of which are duplicated across divisions. Across this we have hundreds of internal committees. These are costly barriers to interaction between our people and with our customers, meaning we lose out too many times on the opportunity to serve them with more products and services.

This complexity shows in our cost:income ratio, which reaches 73% when fully loaded to include the bank levy and restructuring costs. Reducing costs and divesting businesses in the bank will inevitably result in reduced staff levels. We do not yet have detailed plans for implementation and as always we will deal with such matters sensitively, talking to our staff before communicating any such changes.

Trust and Reputation: Behaviour and performance influence the perception of worth. RBS carries huge reputational discount due to the extent of bad headlines the bank attracts. This carries through into our customer and investor interaction and can only be solved by a sustained improvement in the quality of our earnings and meaningful change in the way we deal with customers.

Our customers like and trust the people they deal with, but not the bank itself. We can change this by moving more of the appropriate decision making and process management closer to the people who deal with customers.

Performance: Great companies know that quality service goes hand-in-hand with disciplined management; they chase down costs intelligently so they can invest more for their customers. They prioritise and invest with relentless focus on the areas that deliver the strongest, most sustainable returns.

RBS has earned credibility for the execution of our financial restructuring. The same discipline and focus is now needed on our day-to-day operating performance to better deliver for the customer. The costs that subdue our performance need to be intelligently removed and redirected towards activities that enhance our earnings.

OUR NEW STRATEGY
We now have a strategy to deliver a sustainable bank with a clear ambition: we want to be number one for customer service, trust and advocacy, in every one of our chosen business areas by 2020.

Our ambition aims to deliver a bank that is more trusted than others in the UK. We will earn the trust of customers by serving them better than any other bank.

Quality service leads to repeat business and customer advocacy. Repeat business and higher advocacy leads to sustainable income. We won't compromise on this logic.

The bank will be structured to deliver this ambition by organising around the needs of our customers.

We will collapse seven operating divisions into three customer businesses that can understand our customers' needs and provide appropriate, consistent services far better than we can across current silos.

Our support functions will be smaller, more expert and dedicated to helping the businesses succeed for customers. We will run highly disciplined and well managed conduct and risk functions to maintain safety and soundness.

This will be a highly effective bank and in the medium term we will aim to deliver a cost:income ratio (including bank levy, restructuring charges and, from 2015, the EU resolution fund charge) of around 55%, falling in the long term to around 50%.

The frontline of this bank is where we'll stand out. Accountable, trusted professionals will staff the perimeter of the bank and drive it forward. They will be supported by simple, effective processes on a sound technology platform.

Only 30% of our people today deal directly with the customer. By 2017 more than half will deal directly with the customer and all our people will be measured against our success in improving customer advocacy.

Our focus will be determined by where our customers need us, and where we can serve their needs better than anyone else.

The UK is our home market and our strongest market. It is also our biggest advantage. Our corporate customer trade flows mean we need a strong European and US presence, so this is where we will be. Our UK clients rely on inward investment, so we'll retain a presence in Asia.

Our three customer businesses will cover Personal & Business Banking, Commercial & Private Banking, and Corporate & Institutional Banking. Across the businesses we will have one management team, working to one joined-up plan.

Chief Executive's review

The businesses will be built on franchises that can be number one for customers. We have a family of brands across the bank and will use these to deliver on our ambition.

Not every business in our current structure will be best placed to deliver on our strategy. Technology investment will enable some to improve service at a rate that outpaces the market, but others will not.

For those activities where we can't see a clear path to being number one, we will review on the basis of 'fix, close or dispose'. These will become clear as each of our three businesses defines its new customer franchises over the coming months.

The three businesses of the go-forward bank have been designed against a number of goals. Firstly, they will better serve customer needs than the existing operating divisions. Secondly, they will help eradicate duplication of cost in both the front and back office. Thirdly, they will position us to deliver a sustainable return on equity in each business.

UPDATE ON CAPITAL PLAN
We announced in November that we will target a fully loaded Basel III Common Equity Tier 1 ratio of 12% or greater by the end of 2016 which will principally be delivered through the Capital Resolution Group.

Ahead of the results, we announced that we would take an additional £2.9 billion of charges for litigation and conduct related matters. While these charges were in our future capital plan, provisions were recognised in 2013 and reduced our fully loaded Basel III Common Equity Tier 1 ratio to 8.6% at the end of 2013.

So how do we get to our 12% 2016 target? This will primarily be due to the successful run-down of RCR and the IPO of Citizens, as well as further targeted risk-weighted asset reduction, which will continue to be the main drivers of our plan to deliver our 12% target by the end of 2016.

Citizens Financial Group: The cornerstone of the capital plan is the IPO of Citizens Financial Group in the United States. We have appointed advisers and this is on schedule for later this year.

RCR: The creation of RCR from 1 January 2014 originally identified £38 billion of third party assets that were highly capital intensive. This represented 5% of our funded balance sheet but used up 20% of our capital.

Mainly as a result of the increased impairments we have taken and significantly higher levels of disposals in Non-Core than had been forecast, the opening balance is £29 billion of third party assets and £65 billion of risk-weighted asset equivalents (RWAe). This reduction in assets has also resulted in a corresponding decrease in the bank's funding requirements.

UK branch divestment: To meet our EC-mandated branch divestment, the Williams & Glyn brand will return to the high street via an IPO over the coming years. To achieve this we signed a deal with a consortium of investors led by Corsair Capital and Centerbridge Partners in September 2013. The business will require separation from RBS and this process is well under way.

Ulster Bank: The thinking behind every aspect of our new strategy applies to our business in the island of Ireland.

Consumers and businesses across the island of Ireland deserve a better banking service. To achieve this, however, we must change the way we currently organise our business in the Irish market place. We took the first major step at the end of 2013 when we announced our intention to remove £9 billion of the worst credit risks from the Ulster Bank balance sheet. Our second step is focused on improving customer experience and shareholder return.

As outlined in November, we are reviewing our business to make it viable and sustainable into the future. In this regard we are accelerating our strategy for the bank to improve service to our customers, reduce costs and simplify our operating model.

Our bank in Northern Ireland will benefit from a closer integration with our personal and business franchises in the rest of the United Kingdom. There are meaningful synergies in terms of investment, costs and customer experience from doing this. It is essential if we are to provide a more appealing and compelling service to our customers in Northern Ireland under the Ulster Bank brand.

In the Republic of Ireland we will continue to explore further opportunities to transform our business. We have a range of options but we are now clear on the goal; we will build on our position to be a compelling challenger bank to the domestic pillar banks.

Our customers in the island of Ireland need to know that we are committed to providing them with a great everyday banking service. We will finalise our plans in the coming months – but this is about a change in business strategy not a withdrawal from the market.

These moves are designed to position the bank to do more for our customers and consequently reward our shareholders for their patience.

Chief Executive's review

MEASURES THAT MATTER

We will only succeed in delivering our goals if everyone who works in the bank is clear on the measures that matter. It is too easy to be distracted by measures that flatter progress on things that ultimately don't count towards our ambition.

The measures we use must have credibility with customers and the wider public if we are to regain trust. And they must focus the bank relentlessly on improving returns for shareholders. It is abundantly clear to me that we need to reward our existing shareholders for their patience and attract new ones based on our potential and performance.

Measure 1: Customer
We will target the best Net Promoter Score in the market in the long term in each of our chosen business areas. The most trusted bank in the UK in the long term.

Measure 2: Efficiency
We will aim to deliver a cost:income ratio (including bank levy, restructuring charges and, from 2015, the EU resolution fund charge) of approximately 55% in the medium term, falling in the long term to around 50%. On the same basis, we target a reduction in our costs to approximately £8 billion in the medium term.

Measure 3: Returns
Our overall targeted return on tangible equity (RoTE) will be approximately 9-11% in the medium term. Our long-term RoTE target is 12% plus.

Measure 4: Capital strength
We will target a CET1 capital ratio, on a fully loaded Basel III basis, of 12% or greater by the end of 2016. Our targeted leverage ratio, on the same basis, will be 3.5-4% in the medium term and 4% or above in the long term.

These simple measures mean we will strike a permanent balance between the needs of our stakeholders.

HOW WE'LL DO BUSINESS

The scale of the challenge we have faced over the last few years taught us a simple fundamental lesson: you cannot succeed at your customers' expense. This is why last year we agreed a very simple purpose for the bank: to serve customers well.

Our future is not about us, it's about our customers. These words greet our employees as they walk into our offices every day. They have come to represent a shorthand for what went wrong, but also what we need to get right.

Although we remain in the shadow of our past conduct failings, we have a clear and universal set of values that bind the bank together.

Serving customers
We exist to serve customers. We earn their trust by focusing on their needs and delivering excellent service.

Working together
We care for each other and work best as one team. We bring the best of ourselves to work and support one another to realise our potential.

Doing the right thing

We do the right thing. We take risk seriously and manage it prudently. We prize fairness and diversity and exercise judgement with thought and integrity.

Thinking long term

We know we succeed only when our customers and communities succeed. We do business in an open, direct and sustainable way.

These values are the basis for how we lead, how we reward, how we make decisions and how we treat our customers and each other. They are not yet etched in stone, but become stronger the more they are tested. They are core to us succeeding as a bank.

Chief Executive's review

CONCLUSION:
RBS isn't just any bank. Few, if any, comparisons do justice to the scale of the turnaround that RBS required.

We've got to a point of safety and soundness through a steady focus and patient determination. There will be more things from our past that come back to haunt us, but they will be fewer in number.

Over time, with steady focus and disciplined delivery, the new RBS will emerge. The businesses we operate will be highly effective and relentless in their pursuit of delivering service that makes us number one for customers.

We will be simple to do business with, free from distractions and supported by a strong capital base.

The outcome will be a bank that is truly trusted by customers.

Ross McEwan
Chief Executive
26 February 2014

Economic and monetary environment

It has been noted before that when economies are emerging from recessions rooted in high levels of debt and stresses in the financial system, growth is slower than in the typical recovery. That was the experience again in 2013 in the major markets in which RBS operates.

In the UK, performance improved. Total economic activity, as measured by gross domestic product (GDP), grew by 1.9% compared with growth of 0.3% in 2012. At the start of the year, expectations had been for an increase of only 1.0%. Consumption led the way, despite falling real wages. There were more people in work and households drew down savings to fund spending.

Unemployment fell, from around 7.9% at the start of the year towards 7.0% at its end.

Housing market activity accelerated sharply, prompted in part by measures to encourage house purchases such as Help to Buy. According to the Halifax house price index, the average price of a house in the UK increased by 5.8% during the year. Other indices reported stronger price growth. Prices look to have risen in all parts of the UK but inflation was strongest in London, where prices rose by more than 10%.

Inflation ended the year at the 2.0% target having averaged 2.6% for the year as a whole. The Bank of England continued its ultra-loose monetary policy stance. The Bank Rate remained at 0.5%, although market rates increased towards the end of the year on expectations of tighter monetary policy in the United States. There were no additions to the stock of assets purchased through the quantitative easing programme. In August 2013, the Monetary Policy Committee began offering ‘forward guidance’ on its intentions. It said that it will not consider changing the Bank Rate or the stock of assets purchased until the unemployment rate reaches 7.0%, unless inflation threatens to take off or there are concerns about financial stability.

The Funding for Lending Scheme was adjusted during the course of the year to enhance the incentives for banks to lend to small firms and later to withdraw that support for lending to individuals. The Bank of England’s Credit Conditions Survey suggested that the supply of credit had expanded towards the end of the year.

In the face of considerable fiscal austerity and continuing disputes about the public finances, which led to a government shutdown in the autumn, GDP growth in the United States was 1.9% compared with 2.8% in 2012. There was encouraging news on the job market, where unemployment had fallen to 6.7% in December 2013, although part of the fall was accounted for by people leaving the job market rather than finding work. The housing market again performed strongly, with prices up 14% in the year to November.

In December, the Federal Reserve took the first formal steps towards tightening monetary policy. It announced that it would reduce the amount of assets purchased under its quantitative easing programme by $10 billion each month, with the programme likely to be ended in the second half of 2014. It maintained its guidance that the Fed Funds Target Rate would remain at 0.25% until the unemployment rate reaches 6.5%.

Ireland was able in early 2014 to exit the adjustment programme it had agreed with the European Central Bank, the European Commission and the International Monetary Fund. However, GDP contracted by 0.7% in the four quarters to Q3 2013. The export sector continued to benefit from the boost to competitiveness delivered by falling real wages, although export performance also reflected the decision of companies with limited local activity to domicile in Ireland. For Ireland, gross national product (GNP) is a better measure of the performance of Ireland’s domestic economy and people’s material well-being. It reflects the income residents receive rather than the value of the incomes generated in the country, an important distinction where there is a large foreign owned sector that remits profits overseas. GNP increased by 2.7%.

Unemployment averaged 13.2% and finished the year at 12.4%. House prices rose by 6.4%, the first year-on-year increase since 2007. However, rises were confined to Dublin, where prices increased by 16%. Outside the capital, prices fell slightly. Nationally, prices ended the year 45% below their 2007 level.

Entering 2013, the greatest economic concern was how problems related to sovereign debt in the euro zone would be managed. With the exception of Cyprus, there were none of the episodes of concern that had marked previous years. Markets were generally convinced that the European Central Bank would indeed ‘do what it takes’ to sustain the single currency. Further steps were taken towards a banking union. Nevertheless, the region’s economy remained weak. Unemployment averaged 12.1%, a record, and inflation fell to 0.8% at the end of the year.

Risk overview

Financial strength and resilience are at the heart of our Strategic Plan.

Key themes of 2013

Safety and soundness

The Group continued to pursue its safety and soundness agenda during 2013, with Non- Core's assets falling to £28 billion and Markets repositioning its business, both resulting in risk reduction and lower RWAs.

Whilst the continued deleveraging led to a significant reduction in RWAs, this was more than offset by the impact of the regulatory and redress provisions and increased impairment losses reflecting the establishment of RCR. Our Core Tier 1 capital ratio improved over the year, increasing from 10.3% to 10.9%. The fully loaded Basel III Common Equity Tier 1 ratio also improved in the year to 8.6%.

The Group's liquidity position continued to strengthen and at the end of the year, the liquidity portfolio of £146 billion was more than four times greater than its short-term wholesale funding of £32 billion. The loan:deposit ratio continued to improve and was 94% at the end of the year.

Loan impairment charges were £8.4 billion during 2013 of which £4.5 billion related to the creation of RCR. Underlying impairment losses fell by £1.4 billion and provisions coverage of risk elements in lending increased to 64%, up from 52% a year ago. The Group continued to reduce risk concentrations, notably in commercial real estate. Exposure to eurozone periphery countries also continued to fall, down by 11% to £53 billion at the end of the year. Of this, 70% related to Ireland. The Group still has significant credit risk exposures in absolute terms with credit risk RWAs at £313 billion, following a 16% reduction in the year.

The Group's exposure to market risk continued to fall, with average trading VaR declining to £79 million from £97 million. Market risk RWAs at £30 billion are now less than half their end 2010 level of £80 billion.

Conduct risk is one of the most significant issues facing the bank, and the Group continued to suffer from legacy conduct issues during 2013, notably in relation to PPI, Interest Rate Hedging Products and mortgage-backed and other securities litigation. During the year, the Group focused on embedding good conduct at the heart of its business, working to complete the development of its conduct risk framework and promoting staff understanding of conduct issues. It also worked to enhance its assessment of operational risk to identify important vulnerabilities.

Strategic review

The Group launched a strategic review in the fourth quarter of 2013 to reshape the business to deliver superior customer service. This involved a wide-ranging review of core activities, resulting in the formulation of a plan to address the business challenges of the next five years. While the Group believes the resulting strategy is appropriate, risks remain; the strategy may prove inadequate or the Group may be unable to execute it successfully. Its successful execution, despite increasing regulatory demands and scrutiny as well as a challenging economic environment, is key to the future success of the Group.

To deliver its capital plan, RBS has formed Capital Resolution Group (CRG), which comprises four pillars: exiting the assets in RCR, delivering the IPOs of both Citizens Financial Group and Williams & Glyn, and optimising the bank's group-wide shipping business. RCR was set up from 1 January 2014 and will manage a pool of funded assets (£29 billion) with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate the run-down of these exposures to free up capital for the Group. The Group continues to target a fully loaded Basel III Common Equity Tier 1 ratio of approximately 11% by the end of 2015 and 12% or above by the end of 2016. The timely run-down of RCR and the successful divestment of Citizens Financial Group, in particular, are cornerstones of this capital strategy.

Top and emerging risk scenarios

RBS identifies and monitors its top and emerging risk scenarios. A number attracted particular attention from senior management during 2013, which are discussed below.

Further information on these and other risks see pages 174 to 176.

Risk overview

Macroeconomic risks

- Increased impairments arising from defaults in sectors to which RBS has concentrated exposures, particularly commercial real estate and shipping. Optimisation of the Group's shipping and a significant proportion of commercial real estate portfolios is part of CRG strategy.
- Increased impairments arising from a more severe-than-expected economic downturn. RBS developed business plans to take into account the possibility of slow economic growth and implemented strategies, such as cost reductions, to reduce its earnings vulnerability.
- An increase in RBS obligations to support pension schemes. The trustee is responsible for the investment of the main scheme's assets, which are held separately from the assets of RBS.

Conduct, regulatory and legal risks

- Increased conduct costs and reputational damage arising from a failure to achieve fair customer outcomes. In order to address this risk, during the year RBS continued to embed good conduct at the heart of the business to ensure fair outcomes for customers.
- Increased costs and reputational damage arising from a failure to demonstrate compliance with existing regulatory requirements regarding conduct, particularly with respect to mis-selling. Although more work needs to be done to mitigate this risk, RBS has simplified some products and stopped offering others. Where appropriate, it has compensated purchasers of some products and services, such as payment protection insurance and certain interest rate hedging products.
- Losses or reputational damage arising from litigation. RBS defends claims against it to the best of its ability and co-operates fully with various governmental and regulatory authorities.

Risks related to the Group's operations

- Increased losses arising from cyber attacks. The Group has participated in an industry-wide cyber attack simulation. It has also initiated a program to improve controls over user access, taken steps to rationalise its websites, put anti-virus protection in place and educated staff on information protection.
- Increased losses arising from the failure of information technology systems. RBS has launched a major program to improve resilience, enhanced back-up systems and created a 'shadow bank' capable of providing basic services in the event of need.
- Increased costs arising from a failure to execute successfully major projects. RBS is working to implement change in line with its plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.
- Increased costs due to an inability to recruit or retain suitable staff. RBS has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses.

Political risks

- The Group and the Royal Bank, its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of such referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the Group is subject.
- Were Scotland to become independent, it may also affect Scotland's status in the EU.
- The occurrence of any of the impacts above could significantly impact the Group's costs and would have a material adverse effect on the Group's business, financial condition, results of operations and prospects.

The integral role of risk management

Risk management is essential to making RBS safe and sustainable, and is an activity performed throughout all of RBS operations. A strong culture of risk management and control will provide the foundation for improving performance and deliver future success.

A more detailed discussion of developments in 2013 can be found in the 'Risk and balance sheet management' section on pages 182 to 186.

Sustainability

"The success of a bank depends on two things. A strong financial position; and a reputation for great customer service based on a deep connectivity with the society the bank supports, and is in turn supported by."

Ross McEwan
Chief Executive

Sustainability at RBS means building our future on long term thinking that focuses on our customers and supporting the communities in which they live. We are committed to being open and transparent regarding the challenges faced by our business, so our stakeholders can see what we are doing to become a more sustainable bank. You can read more about the issues raised here, as well as about our wider sustainability agenda, at rbs.com/sustainable.

Governance
The sustainability programme at RBS is built on a robust governance framework that provides direction on our sustainability objectives. The Group Sustainability Committee (the "Committee") is a Committee of the Board and comprises three independent non-executive directors. The Committee is chaired by our Senior Independent Director, Sandy Crombie, and attended by senior representatives from the customer facing divisions as well as Human Resources, Sustainability, Risk Management, Communications, Legal, Strategy and Corporate Services. The Chairman of the board also regularly attends the meetings. The work of the Committee is essential to ensuring that our approach to issues is managed effectively and debated at the appropriate level.

The Committee has overseen a number of important developments within the company since it was established in 2009. For more information on the work of the Committee in 2013, see the report of the Chair of the Committee on page 67.

Stakeholder engagement
Operating in a sustainable manner is about managing our business in a way that takes account of the impact of our activities on our stakeholders. As such, we work with a number of stakeholder groups to understand their views of our organisation, to help shape the way we do business. As a large company we have many stakeholders and we engage with them in a variety of ways, from focus groups to meetings to online forums. These interactions inform decision making and ultimately improve our company. More detail about our stakeholder engagement is available at rbs.com/sustainable.

As part of our wider stakeholder engagement programme, the Committee runs its own programme of structured stakeholder engagement sessions. In 2013, the Committee took part in seven of these stakeholder sessions, open forums where advocacy groups can discuss key areas of concern with the most senior decision-makers in RBS.

We will continue to host these sessions to ensure that we understand our stakeholders' priorities. For more detailed information on these sessions see our sustainability pages on rbs.com.

External commitments
RBS is a signatory to a number of voluntary sustainability commitments and standards. We understand that implementing commitments is an ongoing process, and we are continuously working to integrate these into how we run our business. We are a member of the Equator Principle (EP) Association Steering Committee. The EPs are a voluntary set of standards adopted by banks for determining, assessing and managing social and environmental responsibilities in project financing. We will not provide project finance where the borrower will not, or cannot, comply with these principles of socially responsible investment.

Sustainability

We have been members of the United Nations Global Compact (UNGC) since 2003, the leading platform for the development, implementation and disclosure of responsible policies and practices in the areas of: human rights, labour, environment and anti-corruption.

Each year RBS receives ratings for its environmental and social performance by external indices. RBS has been included in the Dow Jones Sustainability World Index (DJSI) every year since its launch in 1999, achieving our best ever score in 2013. The Index ranks companies' corporate sustainability performance, based on analysis of economic, environmental and social issues like corporate governance, risk management, branding and climate change.

The CDP is an independent, investor-driven organisation which facilitates the measurement and disclosure of Green House Gas (GHG) Emissions for 2,500 organisations in over 60 countries. In 2013 RBS received a disclosure score of 88% and a performance score B.

The FTSE4Good Index Series measures the performance of companies that meet globally recognised corporate responsibility standards. RBS has been included in the FTSE4Good since it was launched 10 years ago.

Transparency and disclosure
We are committed to being open and transparent in our reporting of material issues facing our company. Here we present data on our GHG emissions, diversity data, as well as an update on our approach to managing Human Rights issues. To find more sustainability data read our latest Sustainability Report, available at rbs.com/sustainable.

Managing our impact on the environment
We aim to be recognised as a leader among large global financial institutions in managing our own environmental impacts and developing financial services that support sustainable development.

The activities of RBS and those of our clients can present a number of Environmental, Social and Ethical (ESE) risks and it is our responsibility to manage these risks. We have a robust ESE policy framework, with sector specific policies relating to high risk sectors including oil and gas, mining and metals and forestry.

We are reducing the environmental impact of our operations, led by our 2011 Environment Targets that cover our use of energy, water, waste, paper and CO2 emissions from business travel. In order to ensure our targets continue to be stretching, we have re-examined the baseline on which they are set and adjusted for the decrease in headcount the company has experienced since they were set.

For a full breakdown of our direct environmental impacts, as well as the basis of reporting for the data below, please visit our sustainability pages on rbs.com.

Environmental impacts table

Sustainability

RBS in the Community
We run a number of targeted programmes focused on providing support to the communities where we operate. In addition to this, we have a well established employee volunteering and giving programme in RBS. As well as matching employee donations and fundraising, we also support volunteering during work time. For more information on our community investment please visit rbs.com/sustainable.

Diversity at RBS
We believe it is important that everyone in RBS feels valued and supported. We appreciate the unique perspective and skills that individual staff can bring to the business. Inclusion is more important to RBS than it’s ever been. Through 2013, we’ve taken time to refresh our focus, step back and think about how we support all our colleagues to reach their full potential and better serve our customers. This is delivering a more ‘joined up’ approach to influencing key organisational processes and practices, achieving better balance and sustainable development. We’ve continued to progress diversity and inclusion initiatives (including Sexual Orientation, Disability, Race and Gender). Our inclusion policy standard applies to all employees, in every part of the business, in every part of the world and is published online. The strategy for diversity and inclusion sits with the Board and Executive Committee.

As at 31 December 2013, of our global population of 118,079 employees, 54,370 (46%) were male and 63,709 (54%) female. We had 1,071 senior managers (of which 915 (85%) were male and 156 (15%) were female), which encompasses our executive employee population and individuals who are directors of our subsidiaries. The Company’s Board of Directors has 11 members, comprising eight male and three female directors.

Our approach to Human Rights
We recognise our corporate responsibility to respect and uphold human rights, regularly review our policies and procedures to ensure that we avoid infringing on the human rights of others, both in our own operations and throughout our sphere of influence.

In 2013, we contributed to the Thun discussion paper on the implications of UN Guiding Principles 16-21 for banks and are committed to the implementation of the Guiding Principles within our operations.

We have adopted and contributed to a number of internationally accepted codes, notably the Equator Principles and the UN Global Compact, which specifically address the management of human rights issues. The RBS Group Code of Conduct sets out the standards we expect our people to work to, including a clear commitment to respecting human rights. We listen to our people in a variety of ways, including through an annual employee survey, enabling our people to raise issues regarding their working environment. We also have in place an independent whistleblowing facility for employees to raise concerns, without fear of adverse consequence.

Our Sustainable Procurement Code sets out our expectations of the companies that we work with. It clearly states that our suppliers should not engage in breaches of human rights or labour rights, or in discrimination. We are also committed to equal opportunities for suppliers, and we recognise that diversity strengthens our supply chain.

Our ESE risk policies include sector-specific human rights risk screenings and are regularly reviewed and updated to ensure best practice. We conduct due diligence on clients relating to human rights standards, and expect our clients to share our commitment to respecting human rights within their operations.

Governance report

Letter from the Chairman

Dear Shareholder,

I am pleased to introduce our Corporate governance report, which sets out in some detail how our Board and committees have risen to the challenges of another demanding year.

Board and committee activity increased significantly in 2013, with a number of key strategic issues taking centre stage. In late 2013, the Board agreed a number of actions to accelerate the building of our capital strength and enhance our strategic focus on our core UK businesses and international corporate business. This included the outcomes of the Good Bank/Bad Bank review and the subsequent creation of RBS Capital Resolution (RCR). We also launched a full review of our businesses, focused on the needs of our customers, improving our operations and IT systems, and simplifying our organisational and decision-making structures. Over the last five years, we have made substantial progress in restoring our safety and soundness. Building on that important work, the Board felt the timing was right for this review in order to target our future efforts firmly on how we can best serve the needs of our customers, shareholders and wider stakeholders.

Conduct and culture have been key areas of focus throughout the year and our 2013 results reflect the impact that conduct related matters continue to have on financial and operating performance. The Board fully supports our new values, which were launched in 2013 and focus on serving customers, working together, doing the right thing and thinking long term. It is vital that the Board continues to set the tone from the top to drive essential cultural change and that our governance framework continues to evolve to support this and our key strategic changes. These will be key priorities for the Board and its committees in 2014.

Board committees
Board committees continued to play a crucial role in our governance framework during 2013, undertaking their complex work comprehensively and effectively supporting the work of the Board.

The Group Audit Committee has monitored progress on various regulatory investigations and has overseen the remediation of culture and control issues in the Markets division. The Group Audit Committee has also supported the Board in making its assessment that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, in accordance with new provisions in the UK Corporate Governance Code.

The Board Risk Committee has continued to oversee the remediation activity following the major IT incident in 2012 and is also providing oversight of the investigations underway in response to various allegations made by Mr Tomlinson, customer and adviser to the Department of Business, Innovation and Skills.

With the launch of our new values and programme of cultural change, the Group Performance and Remuneration Committee has played a vital role in ensuring that our remuneration policy supports the desired behaviours. Remuneration decisions are considered in the context of performance on a range of issues, including customer service, and reward behaviours and outcomes that are aligned with our values.

The Group Sustainability Committee has provided oversight of the introduction and embedding of our new values, including the launch of a new code of conduct for our people, and continued its innovative programme aimed at understanding and engaging more effectively with key stakeholders.

Finally, we have established a new committee to provide board level oversight of RCR.

Board changes

There were a number of changes to the Board's composition during 2013. Stephen Hester stepped down as Group Chief Executive having served for over five years on the Board. Stephen's achievements in stabilising the Group during a particularly turbulent period in its history were considerable, and the Board is immensely grateful for Stephen's outstanding leadership and dedication throughout his tenure. Following an extensive internal and external search, Stephen was succeeded by Ross McEwan on 1 October 2013 and Ross now has his sights firmly set on building a bank focused on our customers and shareholders. Also on 1 October 2013, Bruce Van Saun took up his new role as Chairman and Chief Executive of RBS Citizens Financial Group, Inc and has stepped down from the Board. Bruce's contribution was, again, outstanding. He has been succeeded as Group Finance Director by Nathan Bostock. Nathan has since confirmed his resignation although his leaving date has not yet been agreed and the search for his replacement is underway.

Two of our non-executive directors also retired from the Board in 2013. Joe MacHale stood down in May, having served on the Board for nearly nine years. Joe made a substantial contribution to the Board and the committees he served on, providing valuable continuity throughout a challenging period, and on behalf of the Board I would like to express our sincere thanks for his hard work and commitment. Art Ryan also retired in September after more than five years on the Board. The knowledge, wisdom and experience Art brought to the Board and the Group Performance and Remuneration Committee in particular, were greatly appreciated. Art remains on the board of RBS Citizens Financial Group, Inc.

Letter from the Chairman

In December 2013 we welcomed Robert Gillespie as a new non-executive director and I am delighted to say that the Board is already benefitting from Robert's skills and experience. We are also announcing alongside our 2013 results some further Board and committee changes to ensure that we will continue to have an appropriate balance of skills, experience, independence and knowledge. Philip Scott will step down from the Board by 31 October 2014 and I would like to thank Philip for the significant contribution he has made to the Board and the committees he has served on and especially for his strong leadership of the Board Risk Committee during a particularly challenging period for RBS. Baroness Noakes will succeed Philip Scott as Chairman of the Board Risk Committee with effect from 1 April 2014. Following the 2014 Annual General Meeting, Penny Hughes will become Chair of the Group Sustainability Committee replacing Sandy Crombie and Sandy will become Chairman of the Group Performance and Remuneration Committee. I would like to thank both Penny and Sandy for their outstanding commitment and dedication whilst chairing the Group Performance and Remuneration Committee and Group Sustainability Committee respectively.

Board effectiveness

This year, we conducted an internal evaluation of the effectiveness of the Board and its committees, led by the Group Secretary. The evaluation has concluded that the Board is operating effectively but has identified some areas for improvement which we will focus on during 2014.

The Board also received support from the Group Secretary in a number of other areas related to board effectiveness such as Board process and information flows, continuing professional development and induction for new directors.

Corporate governance

This is the first year that we are required to report under the new narrative reporting requirements, which include the new Strategic report and changes in remuneration reporting. Our statement of compliance with the UK Corporate Governance Code (the "Code") is set out on page 94.

Finally, as we reflect on another challenging year, I would like to conclude this letter by recording my sincere thanks towards my fellow Board members. Being a director of RBS requires extensive time and commitment, and the readiness to deal with the unusual challenges of a government controlled listed company. I remain extremely grateful for their continued support and dedication in working towards the recovery of RBS.

Philip Hampton
Chairman of the Board of directors
26 February 2014

Our governance structure

Group Board and Board committee structure

Group Board
The main decision making forum at Group level, setting the strategic direction of the Group and ensuring that the Group manages risk effectively. The Board is accountable to shareholders for financial and operational performance.

Group Audit Committee
Assists the Board in discharging its responsibilities for monitoring the integrity of the financial statements of the Group. It reviews the accounting policies, financial reporting and regulatory compliance practices of the Group and the Group's system and standards of internal controls, and monitors the Group's processes for internal audit and external audit.

Board Risk Committee
Provides oversight and advice to the Board on current and potential future risk exposures of the Group and future risk strategy. It reviews the Group's compliance with approved risk appetite and oversees the operation of the Group Policy Framework.

Group Performance and Remuneration Committee
Responsible for overseeing performance and the Group's policy on remuneration. It also considers senior executive remuneration and makes recommendations to the Board on the remuneration of executive directors.

Group Nominations Committee
Assists the Board in the selection and appointment of directors. It reviews the structure, size and composition of the Board, and membership and chairmanship of Board committees.

Group Sustainability Committee
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.

Executive Committee
Supports the Group Chief Executive in managing the Group's businesses. It reviews strategic issues and initiatives, monitors financial performance and capital allocations and considers risk strategy, policy and risk management.

RBS Capital Resolution Board Oversight Committee
Provides oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

Our Board

Membership of the Group's principal Board Committees has been revised since 27 February 2014:

Group Audit Committee (effective 1 April 2014)
Brendan Nelson (Chair), Baroness Noakes, Philip Scott, Sandy Crombie and Morten Friis (from 10 April 2014).

Board Risk Committee (effective 1 April 2014)
Baroness Noakes (Chair), Brendan Nelson, Philip Scott, Penny Hughes, Robert Gillespie and Morten Friis (from 10 April 2014).

Group Performance and Remuneration Committee (effective following the Group's AGM on 25 June 2014)
Sandy Crombie (Chair), Alison Davis and Robert Gillespie.

RCR Board Oversight Committee (effective 1 April 2014)
Baroness Noakes (Chair), Philip Hampton, Sandy Crombie, Brendan Nelson.

Group Sustainability Committee (effective following the Group's AGM on 25 June 2014)
Penny Hughes (Chair), Alison Davis and Robert Gillespie.

Chairman		
	Philip Hampton (age 60) Date of appointment: 19 January 2009 (Board) 3 February 2009 (Chairman) Experience: Previously chairman of J Sainsbury plc and group finance director at Lloyds TSB Group, BT Group plc, BG Group plc, British Gas and British Steel plc, an executive director of Lazards and a non-executive director of RMC Group plc and Belgacom SA. He is also a former chairman of UK Financial Investments Limited, which manages the UK Government's shareholdings in banks.	External appointment(s): · Non-executive director, chairman of the remuneration committee and member of the audit committee of Anglo American plc and senior independent director with effect from April 2014. Committee membership(s) · Group Nominations Committee (Chair) · RCR Board Oversight Committee
Executive directors		
Group Chief Executive	Ross McEwan (age 56) Date of appointment: 1 October 2013 Experience: Has more than 25 years experience in the finance, insurance and investment industries. He joined RBS in August 2012 as Chief	External appointment(s): None Committee membership(s) · Executive Committee

	Executive Officer for UK Retail, having previously been Group Executive for Retail Banking Services and Executive General Manager responsible for the branch network, contact centres and third party mortgage brokers at Commonwealth Bank of Australia, Managing Director of stockbroking business First NZ Capital Securities, and Chief Executive of National Mutual Life Association of Australasia Ltd/AXA New Zealand Ltd.	
Group Finance Director	Nathan Bostock (age 53) Date of appointment: 1 October 2013. Nathan Bostock has since confirmed his resignation although his leaving date is still to be agreed. Experience: Joined RBS in 2009 as Head of Restructuring and Risk and Group Chief Risk Officer. Prior to this, he spent eight years with Abbey National plc (now Santander UK), latterly as Chief Financial Officer, ten years with RBS in a number of roles, including Chief Operating Officer of Treasury and Capital Markets and Group Risk Director and seven years with Chase Manhattan Bank in a variety of areas and functions. He is a chartered accountant and holds a BSc (Hons) in Mathematics.	External appointment(s): None Committee membership(s) · Executive Committee

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Our Board

Independent non-executive directors

Sandy Crombie (age 65)
Date of appointment: 1 June 2009

Experience: Previously group chief executive of Standard Life plc. He was also previously a director of the Association of British Insurers, a member of the former Chancellor of the Exchequer's High Level Group on Financial Services and Chairman of the Edinburgh World City of Literature Trust. In 2007 he was the Prince of Wales' Ambassador for Corporate Social Responsibility in Scotland.

External appointment(s):
· Chairman of Creative Scotland
· Member and vice-chairman of the Board of Governors of The Royal Conservatoire of Scotland
· President of the Cockburn Association

Committee membership(s):
· Group Sustainability Committee (Chair)
· Board Risk Committee
· Group Nominations Committee
· Group Performance and Remuneration Committee
· RCR Board Oversight Committee

Alison Davis (age 52)
Date of appointment: 1 August 2011

Experience: Managing partner of Fifth Era, an investment firm focussed on early stage technology investments. Previously, she served as a director of City National Bank and First Data Corporation and as chair of the board of LECG Corporation. She has also worked at McKinsey & Company, AT Kearney, as Chief Financial Officer at Barclays Global Investors (now BlackRock) and managing partner of Belvedere Capital, a private equity firm focused on buy-outs in the financial services sector.

External appointment(s):
· Managing partner of Fifth Era Financial LLC
· Non-executive director and member of the finance and compensation committees of Unisys Corporation
· Non-executive director, chair of the compensation committee and member of the audit committee of Diamond Foods Inc.
· Non-executive director, and chair of the audit committee of Xoom Corporation
· Non-executive director and chair of the audit committee at Gamefly, Inc
· Director of the Governing Board of Women's Initiative for Self Employment

Committee membership(s):

· Group Nominations Committee
· Group Performance and Remuneration Committee
· Group Sustainability Committee

Tony Di Iorio (age 70) Date of appointment: 1 September 2011	External appointment(s): None
Experience: Began his career at Peat Marwick (now KPMG) where he worked in the firm's Financial Institutions Practice in New York and Chicago. After leaving Peat Marwick he worked for several leading financial institutions, including as Co-controller of Goldman Sachs, Chief Financial Officer of the Capital Markets business of NationsBank (now Bank of America), Executive Vice President of Paine Webber and CEO of Paine Webber International. He joined Deutsche Bank in Frankfurt in 2001 and later became the Bank's Chief Financial Officer and a member of its Board and Group Executive Committee. After retiring in 2008 he served as senior adviser to Ernst & Young working with the firm's financial services partners in the UK, Europe, the Middle East and Africa. He is a non-executive director of RBS Citizens Financial Group, Inc.	Committee membership(s): ·Board Risk Committee ·Group Audit Committee ·Group Nominations Committee

Our Board

Independent non-executive directors

Robert Gillespie (age 58)
Date of appointment: 2 December 2013

Experience: Began his career with Price Waterhouse (now PricewaterhouseCoopers) where he qualified as a chartered accountant. He then moved into banking joining SG Warburg, specialising in corporate finance, and was appointed as Co-Head and Managing Director of its US investment banking business in 1989. Following the acquisition of Warburg by UBS in 1995, he then held the roles of Head of UK Corporate Finance, Head of European Corporate Finance and Co-Head of its global business and CEO of the EMEA region. He relinquished his management roles at the end of 2005, and was appointed Vice Chairman of UBS Investment Bank. Robert left UBS to join Evercore Partners, from where he was seconded to the UK Panel on Takeovers and Mergers, as Director General, from 2010 to 2013.

External appointment(s):

- Independent Board Director at Ashurst LLP
- Chairman of Council at the University of Durham
- Chairman of the Somerset House Trust
- Chairman of the Boat Race Company Limited
- Director of Social Finance Limited

Committee membership(s):

- Group Nominations Committee

Penny Hughes, CBE (age 54)
Date of appointment: 1 January 2010

Experience: Previously a director and chairman of the Remuneration Committee of Skandinaviska Enskilda Banken AB and a non-executive director of Home Retail Group plc and chairman of its Remuneration Committee. She spent the majority of her executive career at Coca-Cola where she held a number of leadership positions, latterly as President, Coca-Cola Great Britain and Ireland. Former non-executive directorships include Vodafone Group plc, Reuters Group PLC, Cable & Wireless

External appointment(s):

- Non-executive director, chair of the corporate compliance and responsibility committee and member of the audit, nomination and remuneration committees of Wm Morrison Supermarkets plc
- Trustee of the British Museum

Committee membership(s):

- Group Performance and Remuneration Committee (Chair)
- Group Nominations Committee

Worldwide plc and The Gap Inc.

- Group Sustainability Committee

Brendan Nelson (age 64)
Date of appointment: 1 April 2010

Experience: Former global chairman, financial services for KPMG. Previously held senior leadership roles within KPMG including as a member of the KPMG UK board from 1999 to 2006 and as vice-chairman from 2006. Chairman of the Audit Committee of the Institute of Chartered Accountants of Scotland from 2005 to 2008.

External appointment(s):

- Non-executive director and chairman of the audit committee of BP plc
- Member of the Financial Reporting Review Panel
- President of the Institute of Chartered Accountants of Scotland

Committee membership(s):

- Group Audit Committee (Chair)
- Board Risk Committee
- Group Nominations Committee
- RCR Board Oversight Committee

Our Board

Independent non-executive directors

Baroness Noakes, DBE (age 64)
Date of appointment: 1 August 2011

Experience: An experienced director on UK listed company boards with extensive and varied political and public sector experience. A qualified chartered accountant, she previously headed KPMG's European and International Government practices and has been President of the Institute of Chartered Accountants in England and Wales. She was appointed to the House of Lords in 2000 and has served on the Conservative front bench in various roles including as shadow treasury minister between 2003 and May 2010. Previously held non-executive roles on the Court of the Bank of England, Hanson, ICI, John Laing and SThree.

External appointment(s):
- Non-executive director and chairman of the audit committee of Severn Trent plc
- Deputy chairman and senior independent director and chairman of the nominations committee of Carpetright plc

Committee membership(s):
- Board Risk Committee
- Group Audit Committee
- Group Nominations Committee

Philip Scott (age 60)
Date of appointment: 1 November 2009

Experience: Wide-ranging experience of financial services and risk management, including previous responsibility for Aviva's continental European and International life and long-term savings businesses. He held a number of senior executive positions during his career at Aviva including his role as group finance director until January 2010. Fellow of the Institute and Faculty of Actuaries and Fellow of the Association of Certified Public Accountants.

External appointment(s):
- Non-executive director and chairman of the audit committee of Diageo plc

Committee membership(s):
- Board Risk Committee (Chair)
- RCR Board Oversight Committee (Chair)
- Group Audit Committee
- Group Nominations Committee

Group Secretary and Head of Corporate Governance

Aileen Taylor (age 41)
Date of appointment: 1 May 2010

Experience: A qualified solicitor, joined RBS in 2000. She was appointed Deputy Group Secretary and Head of Group Secretariat in 2007, and prior to that held various legal, secretariat and risk roles including Head of External Risk, Retail, Head of Regulatory Risk, Retail Direct and Head of Legal and Compliance at Direct Line Financial Services.

She is a fellow of the Chartered Institute of Bankers in Scotland and a member of the European Corporate Governance Council.

Executive Committee

Ross McEwan, Group Chief Executive
Nathan Bostock, Group Finance Director
For biographies see page 42

Rory Cullinan (age 54)
Chief Executive, RBS Capital Resolution Group
Rory Cullinan became CEO of the RBS Capital Resolution Group (CRG) on 1 January 2014. CRG was set up to deliver, transform, optimise or exit the businesses and assets which will be the primary driver of the RBS capital build. CRG includes RBS Capital Resolution (RCR) and the divestments of both RBS Citizens Financial Group, Inc and Williams & Glyn. He previously served as CEO of the Group's Non-Core Division and also led the negotiation and establishment of RBS's entry into the UK Government's Asset Protection Scheme. Rory previously worked at RBS as Head of Equity Finance (2002-2005). Before rejoining RBS he was Co-Managing Partner and Group Board Member at Renaissance Group. Prior to 2002, he worked for a variety of banks and active financial investment companies in the Americas, Africa and Europe including Permira Advisors, Verdoso Investments (a company he co-founded), Pembridge Investments and Citibank.

Suneel Kamlani (age 52)
Co -Chief Executive, Markets
Suneel Kamlani joined the Group in 2010 and is currently Co-Chief Executive Officer of Markets with responsibility for global trading, sales, research and origination across interest rate products, foreign exchange, asset backed securities, emerging markets, credit fixed income and debt capital markets. In this capacity, he oversees businesses which provide financing, risk management and advisory services to major corporations, financial institutions and public sector clients around the world. Based in the Group's offices in Stamford, Connecticut, Suneel also serves in a regional capacity as Chairman of Markets and International Banking, Americas and Deputy Head of RBS Americas. Suneel has over 30 years of experience in investment banking, having previously served as Chief Operating Officer for UBS's Investment Bank and as a member of the UBS Group managing board. He has worked in New York, London, Hong Kong and Stamford, leading investment banking and capital markets businesses globally.

Les Matheson (age 54)
Chief Executive, UK Retail
Les Matheson was appointed Chief Executive of UK Retail on 11 February 2014. He joined RBS in January 2010 as Managing Director of Products, assumed additional responsibility for Marketing in October 2011 and then served as interim Chief Executive for UK Retail before assuming the role on a permanent basis. Prior to joining RBS, Les was Group Executive Retail for St George Bank (part of the Westpac Group of companies) and before that was with Citigroup for eleven years, where he was CEO Citibank Australia, Citigroup Country Officer for Australia and a member of the Citigroup Global Management Committee. Prior to Citigroup Les worked for a number of consumer marketing companies. He began his career with Procter & Gamble in Brand Management in the UK. Les is a member of the Board of Visa Europe and is a member of the Edinburgh University Court.

Simon McNamara (age 54)
Group Chief Administrative Officer
Simon McNamara was appointed Group Chief Administrative Officer in September 2013. Prior to joining the Group, Simon was Chief Information Officer of Standard Chartered's Consumer Bank based in Singapore and has previously held a number of senior Information Technology and Operations positions in the global financial services industry including with Westpac Banking Corporation, Deutsche Bank, BNP Paribas and Midland Bank. He was also a founding partner in a successful software start-up company, CATS INC, in Silicon Valley. Simon holds a Bachelor of Science (Hons) in Economics and Statistics from University College Swansea and a Post Graduate Diploma in

Computer Science from the University of Hertfordshire. He has also completed the Executive Programme at Stanford University.

Jon Pain (age 56)
Group Head of Conduct & Regulatory Affairs
Jon Pain joined the Group on 15 August 2013 as Head of Conduct & Regulatory affairs, from KPMG where he was a partner and Head of the Financial Services Risk Consultancy practice. Jon has over 30 years' experience in Financial Services including three years as Managing Director of Supervision at the Financial Services Authority (FSA) during the financial crisis (2008 - 2011). Prior to the FSA, Jon's executive career was with the Lloyds Banking Group (LBG) where he held a range of senior roles including Managing Director of LBG's C&G mortgage business, the General Insurance Business and the Private Banking Business.

David Stephen (age 49)
Group Chief Risk Officer
David Stephen joined RBS in July 2010 as Deputy Group Chief Risk Officer, and became Group Chief Risk Officer on 1 October 2013. He is responsible for risk globally across all divisions including credit risk, market risk and operational risk functions and enterprise risk management. Spanning a 28 year career in the finance industry across London, New York, Hong Kong and Melbourne, he has worked for both full service and investment banks. These included Credit Suisse Financial Products where he was Chief Credit Officer and ANZ Bank where he was Group Chief Risk Officer and was a member of ANZ Bank's Management Board. David is a graduate of Melbourne's Monash University.

Executive Committee

Chris Sullivan (age 56)
Chief Executive, Corporate Banking
Chris Sullivan was appointed Chief Executive of the Corporate Banking Division in August 2009 and also has responsibility for Ulster Bank Group. Chris' previous role was as Chief Executive of RBS Insurance. Prior to this, Chris was Chief Executive of Retail and Deputy Chief Executive of Retail Markets. Chris is the Group sponsor for Gender Diversity and the Group's internal Women's Networks and was recognised as the European Diversity Champion of the Year in 2011. He is an active sponsor of professional and leadership development and is a member of the Chartered Banker Professional Standards Board and Governor of Ashridge College. Chris holds a number of positions outside the Group including Chairman of the Global Banking Alliance for women and is a member of the Westminster Abbey Investment Committee. Chris earned his Fellowship of the Chartered Institute of Bankers in Scotland for his services to Scottish Banking.

Bruce Van Saun (age 56)
Chairman & Chief Executive, RBS Citizens Financial Group, Inc. and Head of RBS Americas
Bruce Van Saun was appointed Chairman and Chief Executive Officer of RBS Citizens Financial Group, Inc. and Head of RBS Americas in October 2013. Prior to taking up his current role, Bruce was Group Finance Director and a director of the Company, RBS and NatWest having been appointed to those positions in 2009. Bruce has more than 30 years of financial services experience and has previously held senior positions with Bank of New York, Bank of New York Mellon, Deutsche Bank, Wasserstein Perella Group and Kidder Peabody & Co. Bruce is currently a Director of Lloyd's of London and is a member of the Financial Services Roundtable and The Clearing House supervisory board and is active in several community organisations.

These are the biographies of Executive Committee members as at the date of the signing of the Annual Report and Accounts.

Executive Committee (effective 28 February 2014)
Ross McEwan, Group Chief Executive
Nathan Bostock, Group Finance Director
Chris Sullivan, Deputy Group Chief Executive
David Stephen, Chief Risk Officer
Jon Pain, Group Head of Conduct & Regulatory Affairs
Simon McNamara, Group Chief Administrative Officer
Bruce Van Saun, Chief Executive Officer, Citizens and Head of Americas
Les Matheson, Chief Executive Officer, Personal and Business Banking
Alison Rose, Chief Executive Officer, Commercial and Private Banking
Donald Workman, Chief Executive Officer, Corporate & Institutional Banking
Rory Cullinan, Chief Executive Officer, RBS Capital Resolution Group
Elaine Arden, Group Human Resources Director

Corporate governance

The Board

The Board has eleven directors comprising the Chairman, two executive directors and eight independent non-executive directors, one of whom is the Senior Independent Director.

Name	Position	Nationality
Philip Hampton	Chairman	British
Ross McEwan	Group Chief Executive	New Zealand
Nathan Bostock	Group Finance Director	British
Sandy Crombie	Senior Independent Director	British
Alison Davis	Independent non-executive director	British/USA
Tony Di Iorio	Independent non-executive director	USA
Robert Gillespie	Independent non-executive director	British
Penny Hughes	Independent non-executive director	British
Brendan Nelson	Independent non-executive director	British
Baroness Noakes	Independent non-executive director	British
Philip Scott	Independent non-executive director	British

Biographies for each director and details of which Board Committees they are members of can be found on pages 42 to 45. The Board considers that the Chairman was independent on appointment and that all non-executive directors are independent for the purposes of the Code.

Board Changes

Joe MacHale retired from the Board on 14 May 2013 and Stephen Hester, Art Ryan and Bruce Van Saun all retired from the Board on 30 September 2013. Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013 and Robert Gillespie was appointed to the Board on 2 December 2013. Mr Bostock has since confirmed his resignation although his leaving date is still to be agreed.

Roles and responsibilities

The Board

The Board is the main decision-making forum for the company. It is collectively responsible for the long-term success of the company and is accountable to shareholders for financial and operational performance.

The Board has overall responsibility for:

- the establishment of Group strategy and consideration of strategic challenges;

· the management of the business and affairs of the Group;

· ensuring the Group manages risk effectively through the approval and monitoring of the Group's risk appetite;

· considering stress scenarios and agreed mitigants and identifying longer term strategic threats to the Group's business operations;

· the allocation and raising of capital; and

· the preparation and approval of the Group's annual report and accounts.

The Board's terms of reference include key aspects of the company's affairs reserved for the Board's decision and are reviewed at least annually. The terms of reference are available on rbs.com>about us.

Chairman
The role of Chairman is distinct and separate from that of the Group Chief Executive and there is a clear division of responsibilities with the Chairman leading the Board and the Group Chief Executive managing the Group's businesses on a day to day basis.

The Chairman's key responsibilities are to:
· provide strong and effective leadership to the Board;

· ensure the Board is structured effectively and observes the highest standards of integrity and corporate governance;

· manage the business of the Board and set the agenda, style and tone of Board discussions to promote effective decision-making and constructive debate;

· facilitate the effective contribution and encourage active engagement by all members of the Board;

· in conjunction with the Group Chief Executive and Group Secretary, ensure that members of the Board receive accurate, timely and clear information, to enable the Board to lead the Group, take sound decisions and monitor effectively the performance of executive management;

· ensure that the performance of individual directors and of the Board as a whole and its committees is evaluated regularly; and

· ensure the Group maintains effective communication with shareholders and other stakeholders.

Group Chief Executive
The Group Chief Executive has responsibility for all Group businesses and acts in accordance with the authority delegated by the Board.

The Group Chief Executive's key responsibilities are to:
· exercise executive responsibility for the Group's businesses;

· develop and implement strategy approved by the Board;

· act in accordance with authority delegated by the Board;

· consult regularly with the Chairman and Board on matters which may have a material impact on the Group;

· lead the senior executive team and ensure there are clear accountabilities for managing the Group's business and managing risk; and

· in conjunction with the Group Chairman and Group Secretary, ensure the Board receives accurate, timely and clear information.

Corporate governance

Senior Independent Director

Sandy Crombie, as Senior Independent Director, acts as a sounding board for the Chairman and as an intermediary for other directors when necessary. He is also available to shareholders to discuss any concerns they may have, as appropriate.

Non-executive directors

Along with the Chairman and executive directors, the non-executive directors are responsible for ensuring the Board fulfils its responsibilities under its terms of reference. The non-executive directors combine broad business and commercial experience with independent and objective judgement and they provide independent challenge to the executive directors and the leadership team. The balance between non-executive and executive directors enables the Board to provide clear and effective leadership across the Group's business activities.

The standard terms and conditions of appointment of non-executive directors are available on rbs.com or from RBS Secretariat.

Board Committees

In order to provide effective oversight and leadership, the Board has established a number of Board committees with particular responsibilities. Please see the corporate governance framework on page 41 for more details. The work of the Board committees are also discussed in their individual reports as follows

Nominations Committee - pages 53 and 54.
Group Audit Committee - pages 55 to 60.
Board Risk Committee - pages 61 to 66.
Group Sustainability Committee - pages 67 and 68.
Group Performance and Remuneration Committee - pages 69 to 93.

The terms of reference for each of these committees is available on rbs.com and copies are also available on request from RBS Secretariat.

Group Secretary

Aileen Taylor is the Group Secretary and Head of Corporate Governance. She is responsible for advising the Board on all governance matters and for ensuring that Board procedures are followed. In conjunction with the Chairman and the Group Chief Executive, she is also responsible for ensuring that the Board receive accurate, timely and clear information, particularly on the Group's performance and matters reserved to the Board; facilitating good information flows between Board members; leading on the implementation of the recommendations from the annual Board Evaluation and developing and maintaining the induction and continuing professional development programme for directors. A key element of the role is to ensure alignment between the Board and Executive Management to ensure the appropriate escalation of issues to the Board. Aileen also leads on all aspects of corporate governance across the Group.

Conflicts of interests

The company has procedures in place to ensure that the Board's powers for authorising actual or potential conflicts of interest are operating effectively. On appointment, each director is provided with the Group's guidelines for referring conflicts of interest to the Board. Each director is required to notify any actual or potential conflicts of interest to the Board for consideration and to update the Board on an ongoing basis when he or she becomes aware of any changes.

The Board considers each director's notification separately on the facts and can impose conditions or limitations as part of the authorisation process. Actual and potential conflicts of interest can be authorised by the Board in accordance with the company's Articles of Association. Details of all conflicts of interest are recorded in a register which is maintained by the Group Secretary and reviewed annually by the Board.

Board meetings

In 2013, nine Board meetings were scheduled and individual attendance by directors at these meetings is shown in the table below. One of the Board meetings took place overseas during the Board's visit to the Group's US businesses.

In addition to the nine scheduled meetings, 35 additional meetings of the Board and committees of the Board were held, including meetings to consider and approve financial statements. The Chairman and the non-executive directors meet at least once per year without executive directors present.

	Attended/ scheduled
Philip Hampton	9/9
Ross McEwan (1)	2/2
Nathan Bostock (1)	2/2
Sandy Crombie	9/9
Alison Davis	9/9
Tony Di Iorio	9/9
Robert Gillespie (2)	1/1
Penny Hughes	9/9
Brendan Nelson	9/9
Baroness Noakes	9/9
Philip Scott	9/9
Former directors	
Stephen Hester (3)	7/7
Joe MacHale (4)	4/4
Art Ryan (3)	7/7
Bruce Van Saun (3)	7/7

Notes:

(1) Appointed to the Board on 1 October 2013. Nathan Bostock has since confirmed his resignation although his leaving date is still to be agreed.

(2) Appointed to the Board on 2 December 2013

(3) Retired from the Board on 30 September 2013.

(4) Retired from the Board on 14 May 2013.

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Corporate governance

Principal activities of the Board during 2013

In advance of each Board meeting, the directors are supplied with comprehensive papers in hard copy and/or electronic form. During 2013 there has been an enhanced focus on culture and values, conduct and customers. These have been recurring themes underpinning Board discussions during the year and the Board received regular updates on the cultural change programme. An overview of the principal activities of the Board during 2013 is shown below.

Each meeting	
· Chairman's Report · Group Chief Executive's Report · Monthly Results · Capital, Funding & Liquidity	· Risk Report (including updates on conduct matters) · Reports from committee Chairs · Secretary's Report (routine matters for approval / noting)
1st Quarter	**2nd Quarter**
· UK Retail Deep Dive · Budget Update · Markets Strategy Updates · Remuneration Proposals · Lending Updates · Risk Appetite Framework · Annual Results & AGM Notice · Board and committee Evaluations · Group Internal Audit Evaluation · External Auditor Evaluation	· Non-Core Deep Dive · AGM Preparations · Q1 Results · Markets Strategy Updates · Lending Updates · Recovery and Resolution Planning · Board Session with the Financial Conduct Authority · Good Bank/Bad Bank Review · Board Strategy Offsite · Succession Planning
3rd Quarter	**4th Quarter**
· Good Bank/Bad Bank Review · Parliamentary Commission on Banking Standards Recommendations · Interim Results · Lending Updates · Board Evaluation Update · RBS Citizens Deep Dive	· Launch of Strategic Review · Review of Capital Position · Independent Lending Review · Board Session with the Prudential Regulatory Authority · Corporate Banking Deep Dive · Q3 Results · Markets Deep Dive

· Board Session with the Federal Bank of Boston

Other senior executives, such as the Group Chief Risk Officer and the Head of Conduct and Regulatory Affairs, also attend Board meetings as required to present reports. Divisional Chief Executives, accompanied where appropriate by other senior executives from the division, attend Board meetings to present the divisional deep dives. This provides the Board with an opportunity to engage directly with divisional management on key issues and supports the Board's succession planning activity.

Board effectiveness

Skills and experience on the Board

The Board is structured to ensure that the directors provide the Group with the appropriate balance of skills, experience and knowledge as well as independence. Given the nature of the Group's businesses, experience of banking and financial services is clearly of benefit, and we have a number of directors with substantial experience in that area, but the Board also benefits from directors with experience in other fields.

The table below illustrates the breadth of experience on the Board.

· Retail Banking	· Government & Public Sector
· Risk	· Consulting
· Finance & Accountancy	· Chief Executive
· Private Equity	· Technology
· Investment Banking	· Retailing
· Insurance & Actuarial	· Utilities
· Manufacturing	

Board committees also comprise directors with a variety of skills and experience so that no undue reliance is placed on any individual.

Induction and professional development

Each new director receives a formal induction on joining the Board, which is co-ordinated by the Group Secretary. This includes visits to the Group's major divisions and meetings with directors and senior management. Each induction programme has a core element that the director is required to complete with the remainder of the programme tailored to the new director's specific requirements. An example of an induction programme for a new non-executive director is set out below:

Core meetings	Tailored elements
Group Chairman	Divisional Chief Executives
Group Chief Executive	Divisional visits (UK and overseas)
Group Finance Director	Group Finance
Senior Independent Director	Group Risk
Board committee Chairs	Group Internal Audit
Group Secretary	Group Tax
Group Chief Risk Officer	Investor Relations
Head of Conduct and Regulatory Affairs	Group Strategy
Group Treasurer	Group Communications
General Counsel	
External Auditor	

External Counsel	Institutional Investors

Ross McEwan and Nathan Bostock joined the Board on 1 October 2013. Mr Bostock has since confirmed his resignation, although his leaving date is still to be agreed. Robert Gillespie joined the Board on 2 December 2013. Both Mr McEwan and Mr Bostock were serving executives in the Group prior to their appointment to the Board and as such their induction has been focussed on enhancing their knowledge of Board matters and continuing to build relationships with Board members. A comprehensive induction programme was prepared for Mr Gillespie and is underway.

Corporate governance

The Group Secretary advises directors of appropriate external training and professional development opportunities and internal training is also provided which is relevant to the business of the Group. Business visits are also arranged as part of the Group Audit Committee and Board Risk Committee schedule (details of which can be found on pages 56 and 63) and all non-executive directors are invited to attend. Directors undertake the training they consider necessary to assist them in carrying out their duties and responsibilities as directors.

During 2013, the directors received updates on a range of subjects to enhance their knowledge, including:

- Parliamentary Commission on Banking Standards - Recommendations;
- Banking Reform Bill;
- Department for Business, Innovation and Skills (BIS) Proposals on Transparency and Trust;
- BIS review of Voluntary Code of Conduct for Executive Search Firms;
- Fourth Capital Requirements Directive (CRD IV);
- Competition Commission's investigation into statutory audit services;
- Government reforms on executive remuneration and reporting; and
- Developments in European company law and corporate governance.

The Group Secretary maintains continuing professional development logs. These are reviewed regularly with directors to assist in identifying future training and development opportunities that are specific to the individual director's requirements.

Information
All directors receive accurate, timely and clear information on all relevant matters and have access to the advice and services of the Group Secretary. In addition, all directors are able, if necessary, to obtain independent professional advice at the company's expense.

Time commitment
There is an anticipated time commitment in line with the recommendations of the Walker Review in respect of general Board duties and additional time as necessary in respect of committee duties. However, as stated in the Chairman's introductory letter to his Corporate governance report, the time commitment currently required of our non-executive directors is significant. Each director is required to seek the agreement of the Chairman before accepting additional commitments that might affect the time the director is able to devote to his or her role as a non-executive director. The Board is aware of the other commitments of the Chairman and the other directors are able to allocate sufficient time to enable them to discharge their duties and responsibilities effectively.

Election and re-election of directors
In accordance with the provisions of the Code, all directors of the company are required to stand for election or re-election annually by shareholders at the company's Annual General Meeting. The notice of Annual General Meeting sent to shareholders separately includes details of the proposed resolutions for the election and re-election of directors.

Performance evaluation
In accordance with the Code, an external evaluation of the Board takes place every three years. An internal evaluation takes place in the intervening years.

The 2012 evaluation was conducted externally by a specialist board evaluation consultancy, and a number of initiatives were implemented aimed at improving the overall performance and effectiveness of the Board. These included keeping Board and committee composition under review; reviewing board and executive succession planning; introducing further enhancements to Board information packs; and implementing an expanded remit for the Group Sustainability Committee. These topics will be kept under regular review as a matter of good practice. However, the 2013 evaluation concluded that the recommendations from the 2012 evaluation were being appropriately addressed.

In 2013, the Board and committee evaluation process was conducted internally by the Group Secretary.

Performance evaluation process
The Group Secretary undertook a formal and rigorous evaluation by:

- preparing a detailed framework of key themes for discussion and questions which was used to structure individual meetings held with each director;

- discussing the outcomes and recommendations with the Chairman; and

- recommending the outcomes and areas for improvement to the Board.

Amongst the areas reviewed were Board composition (including diversity), strategy, risk management, Board meetings and processes, external relationships, and the quality of support and information provided to the Board.

Corporate governance

Outcomes of the 2013 performance evaluation

The 2013 performance evaluation concluded that the Board was strong and operated effectively and within its terms of reference throughout 2013. Key strengths identified included the following:

- the Board performed strongly during a challenging 2013, both as individuals and collectively;
- the dynamic between Board members was good, the Chairman successfully steered the Board through a very difficult and complex agenda, and the directors dedicated a significant amount of time and effort to their role; and
- the Board's committees undertook their complex work well throughout the year, providing strong support to the Board.

A summary of the key themes arising from the 2013 performance evaluation is set out below, together with an overview of the proposed actions:

Key themes included	Proposed action
Board and Board committee composition	Keep Board and Board committee composition under review during 2014, to ensure balance of skills, experience, independence, knowledge and diversity remains appropriate.
Strategic oversight	Ensure that Board agendas for 2014 allocate sufficient time for Board oversight of key areas of strategic focus.
Risk reporting	Consideration to be given to the Board Risk Committee leading a review of risk reporting at Board and Board committee level to further enhance the format and content of risk reports.
External relationships	Ensure regular contact with key external stakeholders in order to maintain effective working relationships at Board level.

Individual director and Chairman effectiveness reviews

The Chairman met with each director individually to discuss their own performance and ongoing professional development and also shared peer feedback that had been provided as part of the evaluation process. Separately, the Senior Independent Director sought feedback on the Chairman's performance and canvassed views on the Chairman's performance from the non-executive directors collectively. The results of the Chairman's effectiveness review were then discussed by the Chairman and the Senior Independent Director.

Relations with investors

The Chairman is responsible for ensuring effective communication with shareholders. The company communicates with shareholders through the Annual Report and Accounts and by providing information in advance of the Annual General Meeting. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time throughout the year by letter, telephone or email via rbs.com/ir

Shareholders are given the opportunity to ask questions at the Annual General Meeting or can submit written questions in advance. Directors including the chairs of the Board Committees are available to answer questions at the Annual General Meeting. The Senior Independent Director is also available.

Communication with the company's largest institutional shareholders is undertaken as part of the Investor Relations programme:

- the Group Chief Executive and Group Finance Director meet regularly with UKFI, the organisation set up to manage the Government's investments in financial institutions, to discuss the strategy and financial performance of the business. The Group Chief Executive and Group Finance Director also undertake an extensive annual programme of meetings with the company's largest institutional shareholders.

- the Chairman independently meets with the Group's largest institutional shareholders annually to hear their feedback on management, strategy, business performance and corporate governance. Additionally, the Chairman, Senior Independent Director and chairs of the Board committees met with the governance representatives of a number of institutional shareholders during the year.

- the Senior Independent Director is available if any shareholder has concerns that they feel are not being addressed through the normal channels.

- the Chair of the Group Performance and Remuneration Committee consults extensively with major shareholders in respect of the Group's remuneration policy.

In 2013, the Group introduced a programme of UK based events aimed at individual shareholders. These events provided an opportunity for shareholders to meet with directors and senior management to learn more about the business.

Throughout the year, the Chairman, Group Chief Executive, Group Finance Director and Chair of the Group Performance and Remuneration Committee communicate shareholder feedback to the Board. The directors also receive independent analyst notes and reports reviewing share price movements and performance against the sector. Detailed market and shareholder feedback is provided to the Board after major public announcements such as a results release. The arrangements in place are to ensure that directors develop an understanding of the views of major shareholders and that these are considered as part of the annual Board evaluation.

The Group's Investor Relations programme also includes communications aimed specifically at its fixed income (debt) investors. The Group Finance Director and/or Group Treasurer give regular presentations to fixed income investors to discuss strategy and financial performance. There is also a separate section on the Group's website for fixed income investors which includes information on credit ratings, securitisation programmes and securities documentation. Further information is available at rbs.com/ir.

Report of the Group Nominations Committee

Dear Shareholder,

As Chairman of the Board, I also chair the Group Nominations Committee and I am pleased to present our report on the committee's activity during 2013.

Role and responsibilities

The Group Nominations Committee is responsible for:

- reviewing the structure, size and composition of the Board and making recommendations to the Board on any appropriate changes;

- assisting the Board in the formal selection and appointment of directors (executive and non-executive) having regard to the overall balance of skills, knowledge, experience and diversity on the Board;

- reviewing membership and chairmanship of Board committees;

- considering succession planning for the Chairman and the executive and non-executive directors, taking into account the skills and expertise which will be needed on the Board in the future. No director is involved in decisions regarding his or her own succession; and

- making recommendations to the Board concerning the election and re-election by shareholders of directors under the provisions of the Code. In so doing, they will have due regard to their performance and ability to continue to contribute to the Board in light of the knowledge, skills and experience required and the need for progressive refreshing of the Board.

The Group Nominations Committee engages with external consultants, considers potential candidates and recommends appointments of new directors to the Board. The terms of reference of the Group Nominations Committee are reviewed annually and approved by the Board and are available at rbs.com

Membership and meetings
All non-executive directors are members of the Group Nominations Committee which is chaired by the Chairman of

the Board. The Group Chief Executive is invited to attend meetings.

The Group Nominations Committee holds at least two scheduled meetings per year, and also meets on an ad hoc basis as required. In 2013, five meetings of the Group Nominations Committee were held and the following table illustrates members' attendance at these meetings.

	Attended/ scheduled
Philip Hampton (Chairman)	5/5
Sandy Crombie	5/5
Alison Davis	5/5
Tony Di lorio	5/5
Robert Gillespie (1)	1/1
Penny Hughes	5/5
Brendan Nelson	5/5
Baroness Noakes	5/5
Philip Scott	5/5
Former members	
Joe MacHale (2)	1/1
Art Ryan (3)	4/4

Notes:

(1)	Appointed to the Board on 2 December 2013.
(2)	Retired from the Board on 14 May 2013.
(3)	Retired from the Board on 30 September 2013.

Principal activity during 2013
The Committee continues to monitor succession planning on an ongoing basis taking into account business requirements and industry developments. In 2013 discussions focused principally on executive director succession and the search for new non-executive directors. The Board also held a separate session on succession planning for the Executive Committee in June 2013.

Group Chief Executive succession
On 12 June 2013, it was announced that Stephen Hester would step down as Group Chief Executive and the search for his successor commenced immediately, led by the Chairman on behalf of the Board. MWM Consulting was engaged to support the recruitment process for the new Group Chief Executive and conducted a global search for potential external candidates as well as engaging fully with internal candidates. This enabled the internal candidates to be benchmarked against the very best in the market. The Committee held a number of discussions on potential candidates (internal and external) and agreed that Ross McEwan was the strongest candidate on the basis of his extensive experience in banking, the leadership he had already demonstrated during his time as CEO Retail at RBS and his strong focus on serving our customers. Ross McEwan was announced as the new Group Chief Executive on 2 August 2013 and took over from Stephen Hester on 1 October 2013. MWM Consulting does not provide services to any other part of the Group.

Consideration of new non-executive directors
Egon Zehnder International continued to support the search for new non-executive directors during 2013. Egon Zehnder International were tasked with identifying suitable candidates both to fill existing vacancies (e.g. replacements for Joe McHale and Art Ryan who both retired from the Board during 2013) and to support future Board succession planning. The Committee considered a number of potential candidates during 2013 and Robert Gillespie was appointed to the Board on 2 December 2013. Robert was appointed on the basis of his strong background in

finance and banking and his experience of business and regulatory environments in the UK, US and Europe. The search for future potential candidates is continuing. Egon Zehnder International does not provide services to any other part of the Group.

Report of the Group Nominations Committee

Tenure of non-executive directors

The chart below sets out the tenure of non-executive directors.

Board and committee membership

The Committee reviewed the membership of the Group Sustainability Committee during 2013 following feedback from the 2012 evaluation. It was agreed that an additional non-executive director should be appointed to the Group Sustainability Committee and Penny Hughes was appointed as a member in July 2013.

Boardroom diversity

The Board remains supportive of Lord Davies' recommendations and currently meets the target of 25 per cent female board representation as set out in Lord Davies' report.

The chart below details the gender diversity of the Board.

In accordance with the recommendations contained within Lord Davies' report, the Board operates a boardroom diversity policy and a copy of the Board's diversity statement is available on rbs.com>about us.

The Group understands the importance of diversity and, with regard to gender diversity, recognises the importance of women having greater representation at key decision making points in organisations. The search for Board candidates will continue to be conducted, and nominations/appointments made, with due regard to the benefits of diversity on the Board, however, all appointments to the Board are ultimately based on merit, measured against objective criteria, and the skills and experience the individual can bring to the Board.

The balance of skills, experience, independence, knowledge and diversity (including gender diversity) on the Board, and how the Board operates together as a unit is reviewed annually as part of the Board evaluation. Where appropriate, findings from the evaluation will be considered in the search, nomination and appointment process. If appropriate, additional targets on diversity will be developed in due course.

Further details on the Group's approach to diversity can be found on page 99.

Philip Hampton
Chairman of the Group Nominations Committee
26 February 2014

Report of the Group Audit Committee

Letter from Brendan Nelson,
Chairman of the Group Audit Committee

Dear Shareholder,

2013 has been a year of significant change for the Group, presenting a number of challenges to the Group Audit Committee. The priority of the Committee has been to ensure the quality and transparency of disclosure and the integrity of the Group's financial statements. Most notably the Committee supported the Board in its decision to release a trading statement in advance of announcing the Group's full year results prompted by the recognition of further provisions relating to conduct and litigation, primarily relating to mortgage-backed securities litigation and past conduct issues. These provisions are substantial and have had a significant impact on the Group's performance for the year.

During 2013, the Committee also scrutinised the disclosures relating to management actions to accelerate the rebuild of capital strength and to focus on core businesses (including the creation of RCR), included in the Group's Q3 2013 Interim Management Statement.

A key aspect of the Committee's responsibilities is to satisfy itself that the key accounting decisions, risks and significant management judgements that underlie the financial statements are appropriate through discussion and deliberation with management. The Committee reviewed the conclusions of the External Auditor and, where applicable, other experts and has concluded that disclosures in the financial statements about these judgements and estimates are transparent and appropriate.

Progress on remediating known control issues has remained a focus of the Committee during 2013. On behalf of the Board, the Committee has overseen the Controls and Culture Remediation Programmes within the Markets division and has questioned management in relation to the prioritisation of issues, delivery of remediation, quality assurance and contingency plans. The Committee received reports from Risk Management and Internal Audit and commissioned independent assurance that the programmes were progressing according to plan; that issues were being remediated to industry standard; and that internal reporting accurately reflected progress. On behalf of the Committee I discussed progress and prioritisation with the Prudential Regulatory Authority (PRA). The progress made by management during the course of 2013 was encouraging. However, we will continue to exercise oversight of the areas remediated to ensure improvements are sustained and that further progress is made during 2014.

The Markets Controls and Culture Remediation Programmes have served to underline the importance of an effective three lines of defence model. This was a priority in 2013 and the Committee received regular reports on embedding the model within divisions and functions and articulating the responsibilities and capabilities of the business. Embedding the model and maintaining standards of internal control will continue to be a key priority for the Group during 2014 as the organisational changes announced following the strategic review are implemented. The Committee will monitor this closely.

The Committee has also monitored the progress of various regulatory investigations and claims based on allegations that the Group had inappropriately tried to influence benchmark interest rates. Working closely with the Group Performance and Remuneration Committee, recommendations were made in relation to individual accountability. The Committee continues to consider the output of the review of certain high-risk rates which were not subject to investigation by external authorities.

The annual programme of joint visits by the Group Audit and Board Risk Committees to the Group's business divisions and control functions continued in 2013. The programme allows members of the Committees to spend additional time with areas of the business which the Committees judge would benefit from a more detailed review. Invitations to attend are extended to all non-executive directors. During 2013, the Committees undertook a total of eight visits, including a week long visit to the Group’s operations in Asia and a two-day visit to Ulster Bank. During these visits I took the opportunity to meet with local regulators to gain a better understanding of their perspectives and concerns on our business and key control issues.

In all our work we seek to strike the right balance between on the one hand providing independent oversight and on the other encouragement and support to management. It has been another demanding year for the Group Audit Committee and I would like to extend my thanks to my fellow Committee members for their continued dedication and support throughout 2013.

Brendan Nelson
Chairman of the Group Audit Committee
26 February 2014

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Report of the Group Audit Committee

Report of the Group Audit Committee

Meetings and visits

A total of seven scheduled meetings of the Group Audit Committee were held in 2013, including meetings held immediately before the annual and interim financial statements and the quarterly Interim Management Statements were considered by the Board. The Group Audit Committee also held two ad hoc meetings. Group Audit Committee meetings are attended by relevant executive directors, the Internal and External Auditor and Finance and Risk Management executives. Other executives, subject matter experts and external advisers are also invited to attend, as required, to present and advise on reports commissioned by the Committee. At least twice a year the Group Audit Committee meets privately with the External Auditor. The Committee also meets privately with Internal Audit management.

As in previous years, the Committee has undertaken a programme of visits to those business areas which it considers merit additional focus. During 2013, the Committee spent a week in Asia to review the Markets, International Banking, Wealth, Business Services and Group Finance operations in the region. Internal Audit management made presentations to the Committee at two separate visits, covering functional strategy, bench-strength and capability. Internal Audit Technology resources and capability were discussed during these meetings and over the course of the year the Committee has monitored progress in strengthening capability through recruitment and co-sourcing strategies. The Committee also spent time in Ireland to gain better insight into the issues facing Ulster Bank and held additional in depth meetings with the Markets, International Banking and Wealth divisions in the UK.

Membership of the Group Audit Committee

The Group Audit Committee comprises four independent non-executive directors. The Chairman and members of the Committee, together with their attendance at scheduled meetings, are shown below.

	Attended/ scheduled
Brendan Nelson (Chairman)	7/7
Tony Di Iorio	7/7
Baroness Noakes	7/7
Philip Scott	7/7

All members of the Group Audit Committee are also members of the Board Risk Committee facilitating effective governance of finance and risk issues. The Group Audit and Board Risk Committees have strong links with the Group Performance and Remuneration Committee ensuring that compensation decisions reflect relevant finance and risk considerations.

The members of the Group Audit Committee are selected with a view to the expertise and experience of the Group Audit Committee as a whole. The Board is satisfied that all Group Audit Committee members have recent and relevant financial experience and that each member of the Group Audit Committee is independent as defined in the SEC rules under the US Securities Exchange Act of 1934 (the “Exchange Act”) and related guidance (“Exchange Act Rules”) and the applicable New York Stock Exchange standards (“NYSE Standards”). The Board has further determined that each of Mr Brendan Nelson, Committee Chairman, Baroness Noakes and Philip Scott are “financial experts” for the purposes of compliance with the Exchange Act Rules and NYSE Standards. Full biographical details of the Committee members are set out on pages 42 to 45.

Performance evaluation

An external evaluation of the effectiveness of the Group Audit Committee takes place every three to five years with internal reviews by the Board in the intervening years. An internal review of the Board and its senior committees took place during 2013 following an external review in 2012. Overall, the review concluded that the Group Audit Committee continued to operate effectively.

The role and responsibilities of the Group Audit Committee

The Group Audit Committee's primary responsibilities are shown below and are set out in its terms of reference which are reviewed annually by the Committee and approved by the Board. These terms of reference are available on the Group's website rbs.com.

Report of the Group Audit Committee

Financial reporting and policy
The Group Audit Committee focused on a number of salient judgements and reporting issues in the preparation of the 2013 accounts. In particular, the Committee considered: · the evidence (including in relation to the Group's capital, liquidity and funding position) to support the directors' going concern conclusion. Further information is set out on page 100; · the adequacy of loan impairment provisions, with special emphasis on exposures in Global Restructuring Group (GRG) and Ulster Bank in light of the creation of RCR which resulted in increased impairment provisions being recognised in the fourth quarter of 2013. The Committee was satisfied that the Group loan impairment provisions and underlying assumptions and methodologies are robust; · the level of provisions held for outstanding litigation and regulatory investigations, including Payment Protection Insurance redress, LIBOR, Interest Rate Hedging Products and US RMBS litigation. Following review, the Committee was satisfied that overall the level of provision held is appropriate and that disclosure is sufficiently transparent. However, these issues will be kept under close review by the Committee in 2014, as matters develop; · valuation methodologies and assumptions for financial instruments carried at fair value including the Group's credit market exposures; · the appropriateness of the carrying value of goodwill and other intangible assets, placing particular focus on International Banking and RBS Citizens Financial Group, Inc. Following an impairment review at year end, goodwill allocated to International Banking of £1.1 billion was impaired in full;

· the judgements that had been made by management in assessing the recoverability of the Group's deferred tax assets The deferred tax asset relating to tax losses recognised in The Royal Bank of Scotland plc has been written down by £0.7 billion;

· valuation of the Group's main defined benefit pension scheme. The Committee considered the assumptions that had been set in valuing the fund and the sensitivities of those assumptions;

· the accounting treatment of businesses that the Group has committed to sell, in particular the classification of Direct Line Insurance Group plc in light of the sale of tranches of shares in 2013 and the loss of control by the Group;

· the assessment by management of the adequacy and effectiveness of internal controls over financial reporting which had identified weaknesses in the Group's privileged access and user entitlement controls within Technology Services. The Committee considered the potential impact of those issues upon financial reporting systems and requested assurance directly from management regarding prioritisation of remediation and compensating controls. The Committee will continue to monitor delivery of the required remediation programme in 2014;

° the form and content of the newly introduced Strategic Report contained within the Annual Report and Accounts. As part of its overall assessment of the Annual Report and Accounts, the Committee assisted the Board in determining that the Annual Report and Accounts taken as a whole was fair, balanced and understandable, providing the information necessary for shareholders to assess the company's performance, business model and strategy. A comprehensive review process supports both the Group Audit Committee and ultimately the Board in reaching their conclusion:-

° the production of the Annual Report and Accounts is co-ordinated centrally by the Group Chief Accountant with guidance on requirements being provided to individual contributors;

- The Annual Report and Accounts are reviewed by the Group Disclosure Committee prior to consideration by the Group Audit Committee;

- A management certification process requires members of the Executive Committee and other senior executives to provide confirmation following their review of the Annual Report and Accounts that they consider them to be fair, balanced and understandable; and

- Directors are given sufficient time to consider the Annual Report and Accounts.

This process is also undertaken in respect of quarterly results announcements. In addition, the External Auditor considers the Board's statement as part of its audit requirements.

Report of the Group Audit Committee

Systems of internal control

In addition to the Markets Control and Culture Remediation Programmes, oversight of the three lines of defence model and consideration of accountability in relation to inappropriate rate setting activity (all as more fully described in the letter from the Committee Chairman), the Committee reviewed the progress of the Finance and Risk Transformation Programme. The Committee challenged management on the pace of delivery, cost, prioritisation and benefits. Management is considering the delivery and direction of the programme in light of the organisational changes announced following the strategic review and the Committee will exercise close oversight of the revised programme in 2014.

The Committee has also tracked progress in relation to other mandatory and remedial projects and has challenged individual business areas on the ability to meet regulatory expectations, responsibilities and required resource. The Committee has considered ongoing regulatory reviews and investigations and has monitored the Group's relationship with its principal regulators. It has received reports from the Sensitive Investigations Unit and has considered the appropriateness of action being taken by management in relation to identified issues. The Committee has considered the Group's compliance with the requirements of the Sarbanes-Oxley Act of 2002 and was advised of whistle-blowing events which occurred within the Group. The Committee has requested that Internal Audit consider how whistle-blowing processes can be audited and will seek to identify enhancements to the process.

The Committee also reviewed the effectiveness of the internal Notifiable Event Process during the year; alerts on each event are received by the Chairman of the Committee, and the Chairman of the Board Risk Committee.

Regular reports were received by the Committee on wholesale credit quality assurance testing and consumer credit quality assurance testing. The Committee reviewed the Group's various pension obligations and discussed the status of funding and triennial valuation discussions underway with the RBS Group Pension Fund. The Committee will monitor the investment strategy, capital impact and funding of the scheme during 2014, as negotiations progress.

As discussed in the report of the Board Risk Committee, changes to the Divisional Risk and Audit Committee structure, designed to enhance the effectiveness and transparency of the consideration of risk and audit issues at a divisional level are currently under consideration. Detailed proposals will be presented to the Committee in the first quarter of 2014.

Internal audit

The Group Audit Committee oversaw the work of Internal Audit throughout 2013. Through regular reports and opinions, the Committee obtained insights into Internal Audit's assessment of the control environment across all divisions and of management's level of awareness. The reports from Internal Audit enabled the Committee to monitor internal control within the Group by reporting on areas where improvements to the control environment were needed.

In response to Internal Audit findings during the latter half of 2013, the Committee received at its request a presentation from executives of the Markets division on controls relating to trade and transaction reporting and actions underway to address identified weaknesses. The Committee has asked for regular updates on remediation progress to be provided during 2014.

Internal Audit also highlighted that the volume of change underway across the organisation and some specific regulatory remediation efforts, are key risk areas for the Group. The Committee will focus on these areas in 2014, particularly as the recently announced strategic changes are executed.

During bi-annual visits with Internal Audit, the Committee considered the bench-strength and capability of the function and areas where enhancement was required, including Technology and Markets. Plans in place to make improvements, including strategies to externally co-source certain activities and to accelerate recruitment were discussed to ensure that risks were appropriately covered. The Committee also reviewed Internal Audit's budget and succession-planning.

The Head of Internal Audit continues to report to the Chairman of the Group Audit Committee. In 2013, his secondary reporting line was changed and he now also reports directly to the Group Chief Executive (previously the Group Finance Director). Consideration was given to the presence of the Head of Internal Audit and divisional Heads of Audit at Executive Committee and other senior meetings. The Committee will continue to monitor the participation and influence of Internal Audit at senior level meetings during 2014.

The Committee considered and approved enhancements to the reporting methodology in Internal Audit reports and agreed that the changes to the criteria underlying ratings would improve transparency and provide additional evidence about culture and attitude. These improvements to reporting will be introduced in 2014. Proposed improvements to the evaluation of risk and enhancement to the audit universe, that will enable scoping and prioritisation of the work of Internal Audit that better reflects the scale and complexity of the business, were also considered by the Committee. The impact of assurance work initiated by the Group's regulators on risk coverage was discussed and the annual plan of audit activity was approved.

An external review of the effectiveness of Internal Audit takes place every three to five years, with internal reviews continuing in intervening years. In December 2013, the Group Audit Committee undertook an internal evaluation of Group Internal Audit. The evaluation concluded that Group Internal Audit had operated effectively throughout 2013. Minor observations and recommendations will be progressed. Benchmarking of Internal Audit against the Chartered Institute of Internal Auditors “Effective Internal Audit in the Financial Services Sector” guidance recommendations was explicitly included in the evaluation of effectiveness. Internal Audit currently meets these recommendations in the majority of areas and has incorporated actions within its strategic plan to address identified shortcomings.

Report of the Group Audit Committee

Oversight of the Group’s relationship with its regulators

The Group Audit Committee has a responsibility to monitor the Group’s relationship with the Prudential Regulatory Authority (PRA), Financial Conduct Authority (FCA) and other regulators. During 2013, it received regular reports on the Group’s relationship with all its regulators highlighting significant developments. It received reports on regulatory actions and investigations. Over the course of the year the Chairmen of the Group’s senior Board committees met with the PRA and the FCA on an individual basis and also participated in Regulatory College meetings with the Group’s primary regulators. The Chairman of the Group Audit Committee also met with the PRA and with the External Auditor on a trilateral basis.

The Committee closely monitored the Group’s relationship with its international regulators and significant time was dedicated in particular to understanding the regulatory requirements in the US and their implications for the Group’s US operations and structure. The Committee Chairman also met with the Japanese Financial Services Authority, the Central Bank of Ireland and the Federal Reserve Bank of Boston during local visits.

External audit

During 2013, the External Auditor provided the Group Audit Committee with reports summarising their main observations and conclusions arising from their year end audit, half year review and work in connection with the first and third quarters’ financial results and their recommendations for enhancements to the Group’s reporting and controls. The External Auditor also presented for approval to the Committee their audit plan and audit fee proposal and engagement letter, as well as confirmation of their independence and a comprehensive report of all non-audit fees.

The Group Audit Committee undertakes an annual evaluation to assess the independence and objectivity of the External Auditor and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The annual evaluation is carried out in two stages. An initial review was carried out in early 2014. In assessing the effectiveness of the Group's External Auditor, the Group Audit Committee had regard to:

· the experience and expertise of the senior members of the engagement team;

· the proposed scope of the audit work planned and executed;

· the quality of dialogue between the External Auditor, the Committee and senior management;

· the clarity, quality and robustness of written reports presented to the Committee setting out the External Auditor' findings arising from the audit;

· the quality of observations provided by the External Auditor on the Group's systems of internal control;

· the views of management on the performance of the External Auditor; and

· the findings of any reviews of the work of the External Auditor by relevant regulators and the actions taken, where appropriate, to address any matters raised.

The second phase of the review will be conducted following completion of the 2013 audit and will involve targeted interviews with individuals based on outputs from the initial phase and their level of interaction with the External Auditor.

In addition to the annual evaluation performed by the Group Audit Committee, the External Auditor will also conduct their own annual review of audit quality. Twelve service criteria for the audit have been defined by them to measure their performance against the quality commitments set out in their annual audit plan. Feedback will be obtained and discussed with relevant internal stakeholders. The results of this exercise will be presented to the Group Audit Committee, with actions defined and agreed to address any areas where performance has fallen below expected standards.

The Group Audit Committee is responsible for making recommendations to the Board in relation to the appointment, re-appointment and removal of the External Auditor. In order to make a recommendation to the Board, the Group Audit Committee considers and discusses the performance of the External Auditor, taking account of the outcomes of the annual evaluation carried out. The Board submits the Group Audit Committee's recommendations to shareholders for their approval at the Annual General Meeting.

Deloitte LLP has been the company's auditor since March 2000. There are no contractual obligations restricting the company's choice of External Auditor. The revised UK Corporate Governance Code, issued by the Financial Reporting Council in September 2012 provides that companies should put the external audit contract out to tender at least every ten years. The Competition Commission following their investigation into the supply of statutory audit services also concluded that FTSE 350 companies should tender the audit engagement every ten years. The Group Audit Committee has considered the requirements and emerging developments in the EU and currently intends to put the contract for the 2016 (and future periods) audit of the Group out to tender later this year. In the interim, the Board has endorsed the Group Audit Committee's recommendation that shareholders be requested to approve the reappointment of Deloitte LLP as External Auditor at the Annual General Meeting in 2014.

The Group Audit Committee approves the terms of engagement of the External Auditor and also fixes their remuneration as authorised by shareholders at the Annual General Meeting.

Audit and non-audit services

The Group Audit Committee has adopted a policy on the engagement of the External Auditor to supply audit and non-audit services, which takes into account relevant legislation regarding the provision of such services by an external audit firm.

In particular, the Group does not engage the External Auditor to provide any of the following non-audit services:

· bookkeeping or other services related to the accounting records or financial statements;

· financial information systems design and implementation;

· appraisal or valuation services, fairness opinions or contribution-in-kind reports;

Report of the Group Audit Committee

- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser, or investment banking services;
- legal services and expert services unrelated to the audit; and
- other services determined to be impermissible by the US Public Company Accounting Oversight Board.

The Group Audit Committee reviews the policy annually and prospectively approves the provision of audit services and certain non-audit services by the External Auditor. Annual audit services include all services detailed in the annual engagement letter including the annual audit and interim reviews (including US reporting requirements) and
periodic profit verifications.

Annual audit services also include statutory or non-statutory audits required by Group companies that are not incorporated in the UK. Terms of engagement for these audits are agreed separately with management, and are consistent with those set out in the audit engagement letter to the extent permitted by local regulations. During 2013, prospectively approved non-audit services included the following classes of service:

- capital raising, including consents, comfort letters, reviews of registration statements and similar services in respect of documents that incorporate or include the audited financial statements of the Group;
- accounting opinions, including accounting consultations and support related to generally accepted accounting principles and financial

reporting matters relating to the financial statements of the Group and its subsidiaries;

· any reports that, according to law or regulation in the relevant jurisdiction, must be (and may only be) rendered by the External Auditor;

· reports providing assurance to third parties over certain of the Group's internal controls prepared under US Statement of Auditing Standards 70 "Service Organisations" or similar auditing standards in other jurisdictions; and

· reports and letters providing assurance to the Group in relation to a third party company where the Group is acting as equity/ debt underwriter in a transaction, in the ordinary course of business.

For all other permitted non-audit services, Group Audit Committee approval must be sought, on a case-by-case basis, in advance. The Group Audit Committee reviews and monitors the independence and objectivity of the External Auditor when it approves non-audit work, taking into consideration relevant legislation, ethical guidance and the level of non-audit services relative to audit services. The approval process is rigorously applied to prevent the External Auditor from functioning as management, auditing their own work, or serving in an advocacy role.

A competitive tender process is required for all proposed non-audit services engagements where the fees are expected to exceed £100,000. Engagements below £100,000 may be approved by the Chairman of the Group Audit Committee; as an additional governance control all engagements have to be approved by the Group Chief Accountant and Group Procurement. Where the engagement is tax related, approval must also be obtained from the Head of Group Taxation. Ad hoc approvals of non-audit services are ratified by the Group Audit Committee each quarter. During 2013, the External Auditor were approved to undertake certain significant engagements which are categorised and explained more fully below:

Regulatory requests and attestations (three engagements)
Regulators, both UK-based and overseas, requested certain work be undertaken by the Group during 2013 to provide assurances and meet certain requirements. In all three such engagements undertaken by the External Auditor, their existing knowledge of the Group was highlighted as a strong benefit. It allowed the work to commence quickly and with minimal disruption in all instances. The benefits of maintaining consistency between similar engagements was also highlighted.

Tax advisory and compliance services (one engagement)
Tax advisory services were provided to a subsidiary established by RBS and Blackstone. The External Auditor had been involved in establishing the subsidiary company and so had an in-depth understanding of its structure and tax liabilities.

Membership of a company acquired by Deloitte (one engagement)
Bersin has provided an annual membership to the RBS Group since 2010. This has allowed our HR and Learning & Talent Practitioners to access extensive online research libraries. Bersin was acquired by Deloitte in December 2012 and so at the point the Group’s Bersin membership was due for renewal ad hoc approval by the Group Audit Committee was sought.

Non-statutory audit of full year accounts (one engagement)
As part of the disposal of certain UK branches, it has been necessary to prepare audited accounts for the business for 2012 and 2013. The External Auditor was selected to provide audit services based on its extensive experience of the Group’s systems and process, as well as its specific knowledge of the project. In addition, following the completion of the banking licence application for the business, the new legal entity would be a wholly-owned subsidiary of the Group; it is the Group’s policy to use the Group’s External Auditor to audit the accounts of all subsidiaries except in exceptional circumstances.

In addition, the External Auditor is engaged from time to time by the Group to perform services in relation to the restructuring of loans and other financing. The Group is not liable for these fees, and often has a limited role in the selection process. As an additional governance control, these engagements are subject to the ad hoc approval process. Information on fees paid in respect of audit and non-audit services carried out by the External Auditor can be found in Note 5 to the consolidated accounts on page 395.

Brendan Nelson
Chairman of the Group Audit Committee
26 February 2014

Report of the Board Risk Committee

Letter from Philip Scott,
Chairman of the Board Risk Committee

Dear Shareholder,

Throughout 2013, the Board Risk Committee has sought to continue to provide assurance that the Group is operating in a safe and controlled manner and within the agreed risk appetite framework approved by the Board. This has been done against a backdrop of difficult external market conditions and increased regulatory scrutiny by the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) and the Group's overseas regulators.

In particular, the Committee has focussed on market risk, operational risk, credit risk, conduct and regulatory risk and reputational risk. In its consideration of each area of risk, culture has been the priority and the Committee has emphasised the importance of instilling the correct behaviours within the organisation, alongside processes and tools designed with the customer at the fore. It is vital that the business is able to get these things right in order to meet its target of becoming a 'really great bank'. The Committee is working hard to drive cultural change and increase accountability throughout the organisation.

Oversight of risk has been enhanced in the period, through the separation of the Risk Management and Conduct and Regulatory Affairs functions. The restructure of the Risk function has enabled the Committee to achieve clearer and more effective oversight of conduct and regulatory issues, which will have long-lasting benefits. The Committee dedicates substantial time each year to the oversight of the risk operating model and succession planning and will continue to monitor these changes during 2014 as the respective functions continue to strengthen and embed.

Conduct risk standards continue to be communicated to employees using the four pillars of conduct risk: employee conduct; market conduct; corporate conduct; and conduct towards customers. These standards have been applied in the Committee's consideration of issues including the review of the sale of interest rate hedging products to SME customers. The Committee has also placed renewed focus on the quality of advice provided to customers, particularly in relation to mortgages, investment products and private client products.

In response to the allegations set out in the Tomlinson Report that the Group's restructuring division systemically set out to make profit at the expense of distressed customers, an independent review by the law firm Clifford Chance was commissioned to investigate these claims fully. The Group's regulators will also undertake their own review. While no evidence has been produced that supports the claims set out in the Tomlinson Report, the allegations have damaged our reputation and threaten to undermine our ability to build trust with customers and to increase lending to businesses in the UK economy. Therefore it is essential that the Group verifies the facts as quickly as possible. The Board Risk Committee has undertaken to review the outputs of both investigations, in depth, on behalf of the Board and make recommendations as to action required.

During 2013, the Board Risk Committee has continued to oversee the remediation activity following the major IT incident in 2012 and the ongoing effort to ensure the Group is more resilient in this respect in future. The Committee has also considered other potential single points of failure and how these can be identified and prevented or mitigated. This focus will continue in 2014 and the Committee will continue to liaise with its principal regulators during the first quarter of the year as the investigation of the IT incident concludes.

The Committee has considered reports on data quality, information security and corporate security with a particular focus on cyber security. This continues to be a significant issue for the banking industry as a whole and will remain a priority for the Committee in 2014.

Consideration of the case for RCR and substantiation of the capital plan was a major undertaking for the Group in the latter half of 2013. Given the fundamental strategic importance of this review, consideration, analysis and approval was undertaken collectively by the Group Board rather than at Committee level, which I consider to be appropriate. As a priority in 2014, the Board Risk Committee will monitor the risks in execution of this plan and also execution of the measures announced following the strategic review.

While 2013 has presented significant challenges, there has also been significant progress in the oversight of risk and control in many areas. In particular I would highlight the following:

- the Committee has continued to enhance its relationship with other Committees, in particular the Group Performance and Remuneration Committee. It has advised on matters such as assessing risk performance of both divisions and individuals, reviewing the risk objectives of members of the Executive Committee and considering the accountability of individuals in relation to specific matters;

- the role of Divisional Risk and Audit Committees has been reviewed in conjunction with the Group Audit Committee to ensure that they provide more transparency and more effective consideration of risk at a divisional level. Proposed changes to the existing model will be considered by the Committee in Q1 2014;

Report of the Board Risk Committee

- the Committee has overseen the refinement and further embedding of the Group's risk appetite framework into the business divisions;

- the Committee considered the outputs of stress testing and approved a reverse stress test trigger framework to further assist the risk management team in assessing how the business is positioned to respond to various potential scenarios; and

- an economic capital framework was presented and the Committee considered how this would be transitioned into business as usual.

More detailed information on each of these areas is set out in the Board Risk Committee report that follows.

2013 was a challenging year for the Board Risk Committee and I would like to extend my gratitude to my fellow members and to the Group's senior leadership team for the additional time that they have dedicated to the business of the Committee.

Philip Scott,
Chairman of the Board Risk Committee
26 February 2014

Report of the Board Risk Committee

Report of the Board Risk Committee

Meetings and visits

The Board Risk Committee held seven scheduled meetings in 2013. Meetings are held alongside Group Audit Committee meetings to ensure that the work of the two Committees is coordinated and consistent. Board Risk Committee meetings are attended by relevant executive directors, risk management, finance and internal audit executives. External advice may be sought by the Board Risk Committee where considered appropriate. During 2013, the members of Board Risk Committee, in conjunction with the members of the Group Audit Committee, took part in an annual programme of visits to the Group's business divisions and control functions. This programme included two in depth sessions with the Risk Management function to consider key risk areas and the risk strategy and operating model. Full details about the programme of visits is set out in the Report of the Group Audit Committee on page 56.

Membership of the Board Risk Committee

The Board Risk Committee comprises at least three independent non-executive directors. The Chairman and members of the Committee, together with their attendance at meetings, are shown below.

	Attended/ scheduled
Philip Scott (Chairman)	7/7
Sandy Crombie	7/7
Tony Di Iorio (1)	6/7
Brendan Nelson	7/7
Baroness Noakes	7/7
Former director	
Joe MacHale (2)	2/4

Notes:

(1)	Missed one meeting due to travel disruption.
(2)	Retired from the Board on 14 May 2013.

Philip Scott, Tony Di Iorio, Brendan Nelson and Baroness Noakes are also members of the Group Audit Committee. Sandy Crombie is also a member of the Group Performance and Remuneration Committee. This common membership ensures effective governance across all finance, risk and remuneration issues, and that agendas are aligned and overlap is avoided, where possible.

Performance evaluation

A review of the effectiveness of the Board and senior committees, including the Board Risk Committee, during 2013 was conducted internally. The Committee has considered and discussed the report on the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted, the conclusions and the recommendations for action. Overall, the review concluded that the Board Risk Committee continued to operate effectively but some areas where further enhancements could be made, were identified. The outcomes of the evaluation have been reported to the Board, and during 2014, the Committee will place focus on driving further improvements to risk reporting and prioritisation of Committee time.

The role and responsibilities of the Board Risk Committee

The Board Risk Committee's primary responsibilities are shown below and are set out in its terms of reference which are reviewed annually by the Committee and approved by the Board. These are available on rbs.com.

Report of the Board Risk Committee

Risk strategy and policy

RBS has a clear risk strategy supported by well defined strategic risk objectives. The members of the Board Risk Committee provide input to the overarching strategy for the business on an ongoing basis.

During 2013, the Board Risk Committee reviewed the implementation of the Group Policy Framework across the organisation. It also reviewed the output of control environment certifications which provided the Committee with an assessment of the effectiveness of the Group's internal control environment. Particular focus was placed on how the operational risk framework was structured to identify single points of failure and "black swan" events, being those events that were difficult to predict but would have a high impact. The Committee agreed that Risk Management should reinforce with divisions that risk assessments and scenario analysis should extend to these events and that consideration should also be given to resilience.

Together with the Group Audit Committee, throughout 2013, the members placed particular focus on the implementation and embedding of the three lines of defence model across divisions. While progress has been made, the Committee recognises that additional work is required to fully delineate responsibilities across front line management, risk and internal audit. The Committee has emphasised that it considers effective operation of the model to be a priority and will closely monitor progress in 2014 alongside strategic and organisational change.

The Committee also considered management's plans to deliver a holistic Enterprise Risk Management (ERM) framework, intended to deliver an increase in effectiveness and make risk more relevant to the operation of the business. This would involve rationalising existing risk management tools and making them integral to business as usual. The Committee noted its emphatic support to the accelerated programme of work planned for 2013/2014 which including the development of outcome-focused principles of business and the use of tools such as the "yes check" to align values with customer outcomes based on integrity, safety, soundness, reputation and standards.

The members closely reviewed implementation plans and delivery of solutions to meet the requirements of the Single European Payments Area. The Committee in particular has monitored the relationship with the Central Bank of Ireland in this regard.

The Committee has received reports on plans underway to enhance data quality across the organisation. It has also considered information security, corporate security and cyber risk.

Risk profile

Reporting
The Committee received a detailed report on key risks and metrics at each meeting and the Group Chief Risk Officer provided a verbal update on the key risks to the organisation. Following his appointment, the Head of Conduct and Regulatory Affairs also provided a verbal update on current pertinent matters to the Committee at each meeting. These reports enabled the Committee to identify the key risk areas where additional focus was required.

During 2013, the Committee has continued to focus on enhancing risk reporting and some improvements have been made, including the creation of a risk report at entity level of National Westminster Bank Plc. However, the annual Committee performance evaluation has highlighted that more work is required to rationalise the reports that are received by the Committee; to ensure that key risks are conveyed succinctly and prominently; and to standardise and simplify presentations. This will be taken forward in 2014.

The Committee reported to the Board following each meeting on its consideration of the risk profile of the business and made recommendations as appropriate.

Risk Incidents and Regulatory reviews and investigations

As in previous years, regulatory risk featured highly on the agenda of the Committee during 2013. Most significantly, as highlighted above, in the letter from the Committee Chairman, the Committee continued to play a central role in the oversight and remediation of the Group’s 2012 IT incident. It received regular reports on the work being undertaken to enhance resilience and address root causes of the issue and has challenged management on the robustness of plans and in relation to capability across the three lines of defence. Significant progress has been made to address the deficiencies highlighted by the incident. However, longer term investment in further enhancement to the Group’s infrastructure is ongoing. The Committee will continue to oversee the remediation activity and wider enhancement required to systems and resilience during 2014. The Committee will also work with its regulators to address findings as their investigation of the incident concludes and will ensure accountability is fully considered and learnings are adopted, across the organisation.

The Committee was dismayed to learn of the most recent system outage in late 2013 and will ensure that this matter and any correlation with the earlier IT incident is fully understood.

The allegations set out in the Tomlinson Report have been taken very seriously by the Group and while there is no evidence of systemic wrongdoing in the way distressed customers were treated by the Group’s restructuring division, an independent review by Clifford Chance has been commissioned. The FCA has separately appointed a skilled person to undertake a review under section 166 of the Financial Services and Markets Act. The Board Risk Committee will review the outputs of these investigations and will liaise with its regulators as required.

Report of the Board Risk Committee

A number of other internal and regulatory investigations arose or continued throughout 2013. During the period, the Committee received reports on;

- the investigation of the alleged mis-selling of interest rate hedging products to small and medium sized enterprises and considered the appropriateness of remediation activity;

- the investigation of allegations of inappropriate rate setting activity in particular foreign exchange rates;

- anti-money laundering remediation including divisional remediation plans, prioritisation and resource requirements;

- the sale of complex products and the quality of investment advice to customers. In particular, it received reports on required enhancements to the mortgage sales process. The sales and product design and approvals process were also reviewed;

- the status of key litigation cases, in particular the US residential mortgage-backed securities litigation claims; and

- the remediation of known regulatory issues in the RBS Americas region.

Where appropriate, the Committee oversaw liaison with regulators; made recommendations regarding required remediation, training and process controls and enhancements; and made recommendations to the Group Performance and Remuneration Committee in relation to accountability. Progress to address identified weaknesses will be closely monitored throughout 2014.

In 2013, the Balcony Oversight Committee was established in acknowledgment of the volume of ongoing conduct issues, particularly in the Markets division. The aim of the Balcony

Oversight Committee chaired by the Head of Conduct and Regulatory Affairs, is to provide independent oversight, identify common themes and to share lessons learned. The Balcony Oversight Committee reports to the Board Risk Committee and regular updates were provided on the status of ongoing investigations and emerging themes.

Capital and liquidity
The Committee reviewed the capital and liquidity position of the business regularly in light of external conditions.

The Committee made recommendations to the Board concerning the Individual Liquidity Adequacy Assessment, the Internal Capital Adequacy Assessment Process (ICAAP) and the Contingency Funding Plan, in line with the Group's commitments to its regulators.

Risk appetite framework and limits

The risk appetite framework for the Group was reviewed in 2013 to ensure it remained fit for purpose in light of internal restructuring, market positioning and changes to regulation. Consideration was given to how risk appetite linked to strategic objectives and how quantitative risk appetite targets had been set. The Committee discussed earnings volatility, including the impact of diversification benefit on the targets. Following detailed discussion, the Committee recommended the framework to the Board for approval and noted its support to management as the framework was embedded across the Group at divisional level. The Board Risk Committee separately reviewed the country risk appetite and Group Market Risk Control Framework and noted new market risk caps and changes to the existing limits.

In the second half of 2013 the Committee reviewed proposed changes to the Single Name Concentration framework for Banks and a new Single Name Concentration grid for Large Corporates.

The Committee also considered the Economic Capital model, which had been under delivery since 2010. It was noted that the model was now being transitioned to business as usual activity and had been used to assess credit concentration risk for Pillar 2 capital as part of the 2011 ICAAP, resulting in a more accurate capital calculation. The Committee is confident that the model will provide management with a clearer understanding of risk.

The Committee continued to review the output of stress testing and discussed the stress scenarios and underlying assumptions. In the second half of 2013, the Committee noted the output of a reverse stress testing exercise and recommended it for approval to the Board.

Risk management operating model

During the course of two separate visits to Risk Management, the Committee reviewed the risk management operating model to ensure the function had the appropriate structure and resources in place to deliver its strategic plan. Bench-strength of the risk function was reviewed and consideration was give to succession-planning, resource and budget.

The strengthening of the Conduct and Regulatory Affairs function during the second half of the year resulted in various changes to the risk management operating model which were discussed in detail with the Committee. Further developments to Risk Management, Conduct and Regulatory Affairs and the risk committee framework that underpins the Board Risk Committee will continue to be progressed in 2014 and the Committee will remain involved in the discussions and changes as appropriate.

As referenced in the Group Audit Committee report on pages 56 to 60, a framework of Divisional Risk and Audit Committees is responsible for reviewing the business of each division and reporting to the Group Audit Committee and Board Risk Committee. During 2013, the Committee reviewed the operation of the committees and requested that management consider alternative mechanisms that could more effectively provide a line of sight into divisional risk issues and activity. The output of that review, will be more fully discussed in Q1 2014.

Report of the Board Risk Committee

Risk architecture
The Committee reviewed the preparations underway to ensure compliance with the new best practice principles that had been defined by the Basel Committee of Banking Supervision (BCBS) for internal risk reporting and data aggregation practices, which would be effective in 2016. Consideration was given to how these requirements reaffirmed priorities and direction of travel with the Finance and Risk Transformation (FiRST) Programme and it was noted that work was in progress to both accelerate usage of the FiRST strategic solution by Risk and enhance existing capabilities. In conjunction with the Group Audit Committee, the Board Risk Committee will closely monitor delivery of the FiRST programme in 2014 and any required changes as a result of the strategic review.

Remuneration
The Committee recognises that embedding the correct conduct and culture in the organisation requires an emphasis on performance management and conduct standards. The Board Risk Committee has continued to work closely with the Group Chief Executive and Group Performance and Remuneration Committee to consider the risk aspects of Executive Committee members' objectives and remuneration arrangements as appropriate. The Committee considered the risk performance of divisions in light of known risk and control issues and under advice from Risk Management and Internal Audit. It made recommendations regarding appropriate adjustments, to the Group Chief Executive and Group Performance and Remuneration Committee. The Committee has reviewed specific accountability cases as required and made recommendations accordingly.

Philip Scott
Chairman of the Board Risk Committee
26 February 2014

Report of the Group Sustainability Committee

Letter from Sandy Crombie
Chairman of the Group Sustainability Committee

Dear Shareholder,

Early in 2013 the remit of the Group Sustainability Committee was increased to include broader sustainability issues including conduct, culture, reputation and most importantly, how the Group serves its customers.

Membership was strengthened with an additional non-executive director and meeting frequency was also increased, all underlining our commitment to the sustainability agenda.

While 2013 presented significant challenges, progress was made by the Committee in overseeing and challenging how management was addressing sustainability and reputation issues relating to all stakeholder groups. Key areas of work during the year included:

- oversight of the introduction and embedding of the purpose, vision and values work intended to promote behavioural change and strengthen our culture Group-wide. This included the introduction of the Code of Conduct which lays out the standard of conduct that supports the Group’s values of serving customers, working together, doing the right thing and thinking long term;

- oversight of how the Group is balancing the needs of all its stakeholder groups including customers, investors, employees, regulators and communities/society and alignment with the Group’s strategic intent;

- ongoing commitment to the stakeholder engagement programme through regular face to face sessions with advocacy groups on key issues of concern. This has been a key area of progress for the Committee allowing for challenge and debate in an open and collaborative environment (more details on next page);

- oversight of development of Environmental, Social and Ethical (ESE) policies to ensure increased transparency and disclosure and more responsible management of risks in sensitive and high risk sectors. ESE policies reviewed in 2013 included Mining and Metals, Oil and Gas and Gambling;

- receiving reports on the sustainability activities across the company including supporting enterprise, employee engagement, citizenship, environment, safety and security;

- improved reporting through the annual Sustainability Report which provides a review of our activities and details future commitments, goals and priorities. We adhere to best practice standards for our reporting, following a principles framework of inclusivity, materiality and responsiveness. Deloitte LLP undertake independent assurance of our reporting and were able to provide an unqualified assurance statement in respect of the 2012 Sustainability Report which was published in May 2013;

- receiving reports on people issues including health and safety, diversity and inclusion, employee wellbeing and employee opinion; and

- receiving reports on legal issues and legislative changes that impact the sustainability agenda.

Other areas supported by the Committee included the adoption of a number of internationally accepted voluntary codes notably the Equator Principles, United Nations Global Compact and Natural Capital Declaration (see pages 35 to 37 for more detail).

Although much still has to be done, it is pleasing that the efforts to build a sustainable and responsible business have been recognised through independent and external measures such as inclusion in the Dow Jones Sustainability World Index with our highest score to date in 2013. We have also been included in the FTSE4Good Index Series which measures the performance of companies that meet globally recognised corporate responsibility standards (see pages 35 to 37 for more information on these external commitments).

To continue the progress made in 2013, a priority for the Committee will be to ensure that its strategic direction is aligned with business priorities and that sustainability is embedded in everything that we do.

Finally I would like to thank my fellow Committee members for their expertise and guidance and all those who have supported us, whether inside or outside RBS, for their contribution to our work.

More detailed information on the Committee and the Group's approach to sustainability is found on pages 35 to 37.

Sandy Crombie
Chairman of the Group Sustainability Committee
26 February 2014

Report of the Group Sustainability Committee

Report of the Group Sustainability Committee

Meetings

The Group Sustainability Committee held six Committee meetings in 2013 in addition to seven stakeholder engagements sessions. Both were attended by senior representatives from the customer facing divisions as well as Human Resources, Sustainability, Risk Management, Communications, Legal, Strategy and Corporate Services. The Chairman of the Board regularly attends the meeting as well as internal and external specialists who may be requested to attend for specific items.

Stakeholder Engagement Sessions

Balancing the needs of stakeholders means understanding the views of all those who have an interest in our business. In addition to ongoing engagement throughout RBS with internal and external stakeholders, during the year, the Group Sustainability Committee participated in seven stakeholder engagement sessions covering the following topics:

- Fair Banking;
- Safety and Security;
- Citizenship;
- Supporting Enterprise;
- Sustainability priorities in the USA;
- Investor Perspective; and
- Employee Engagement.

These stakeholder engagement discussions help inform decision making across the Group, shape future polices and influence strategic priorities and will continue to play a key role. For more information see pages 35 to 37.

In 2013, a programme of UK based events aimed at individual shareholders was introduced. These events provided an opportunity for shareholders to meet directors and senior management to learn more about the business.

Membership

The Group Sustainability Committee comprises three independent non-executive directors. The Chairman and members of the Committee, together with their attendance at meetings, are shown below.

	Attended/ scheduled
Sandy Crombie (Chairman)	6/6
Alison Davis (1)	5/6
Penny Hughes (2)	3/3

Notes:

(1) One meeting missed due to time zone differences.

(2) Appointed to the Committee with effect from 30 July 2013.

Performance evaluation

An internal review of the effectiveness of the Group Sustainability Committee took place in 2013. Overall the review concluded that the Group Sustainability Committee continued to operate effectively. An ongoing challenge will be to ensure that the Group’s strategy covers the long term needs of all stakeholders and that the work of the Group Sustainability Committee is fully aligned with that strategy.

Role and responsibilities of the Group Sustainability Committee
The Group Sustainability Committee is 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 another Board committee.

Authority is delegated to the Group Sustainability Committee by the Board and the Committee will report and make recommendations to the Board as required. The terms of reference of the Group Sustainability Committee are available on the Group's website rbs.com and these are considered annually by the Group Sustainability Committee and approved by the Board. A report on the activities of the Group Sustainability Committee in fulfilling its responsibilities is provided to the Board following each Committee meeting. The principal responsibilities of the Group Sustainability Committee are shown below aligned to the Group's values.

Directors' Remuneration Report

Annual Statement from the Chair of the Group Performance and Remuneration Committee
Penny Hughes

Dear Shareholder,

This year's remuneration report is published at an important moment for RBS. Five years on from the company's rescue, RBS is substantially safer and smaller, has a new Group Chief Executive, and has embarked on a new strategy positioning customers at its centre. In this changing environment, the complex challenges surrounding remuneration that I have written about in this space for the last few years, have not gone away.

The Committee is tasked with making decisions on pay that encourage good service to our customers, are fair to all of our employees, and are in the interests of all of our shareholders. These decisions are never easy and are rarely popular in all quarters. Sometimes it would be easier for the Committee to make different decisions, prioritising the needs of one stakeholder group over another. We understand why RBS is subject to public and political scrutiny and has an obligation to the public that goes beyond that of our competitors. But truly living up to our responsibilities means we have to reject easy options which are not in the long-term interests of our stakeholders.

2013 performance – a challenging year
Although now safer and more secure than it was five years ago, RBS is still beset by issues that have their roots in the past. Our substantial loss for 2013 arises primarily from the decision to remove more of the bad assets from our balance sheet and make additional provisions for conduct and litigation issues. It is a matter of great regret that it is against this background that I have to make this report. I know shareholders had hoped that losses like this would have been well behind RBS by now. Those who served on the Executive Committee during the year did not receive any bonus for 2013. Most of this team is relatively new, but this was an important leadership issue.

Continuing pay reform
There has been a fundamental cultural shift in our approach to pay:

- Over the last four years alone, bonus pools have fallen by 58% at a Group level and by 75% within the Markets division.

- The Group bonus pool has fallen between 2012 and 2013 in line with the fall in pre-RCR operating profit.

- The underlying reduction is significantly greater when taking account of the deduction made last year for LIBOR.

- The percentage of staff receiving no bonuses has increased over the last year from 40% to 43% as we continue to target high performers.

- In our UK retail business, incentive schemes for customer facing staff have minimum standards relating to customer and risk measures which must be met before any payments can be considered.

-

Performance related pay is linked to a combination of performance measures covering financial and non-financial metrics.

Operating in markets where absolute and relative levels of pay are still high, RBS has been a back-marker. But we do not and cannot operate in a vacuum. Many of our employees have done good work this year to help rebuild the company for the future. While pay in aggregate will continue to remain at the lower end of current market practice, I firmly believe our pay levels must remain competitive to attract and retain a high calibre of staff. This is essential if we are to build a business of value for our customers and our shareholders.

It is worth noting that bonuses and other variable pay arrangements are standard practice for FTSE100 companies, not just banks. Research indicates that 99% of executives in the FTSE100 at Executive Committee level or above have a variable to fixed pay ratio that exceeds 1:1.

I know it is not always easy to accept, but if RBS is to thrive we must do what it takes to attract and keep the people who will help us achieve our goals. We think that the right positioning of the business is to be commercial. While we are sensitive to public opinion, particularly given our ownership structure, the ability to pay competitively is fundamental to getting RBS to where we need it to be.

Directors' Remuneration Report

There is an understandable public focus on the highest paid specialist talent at RBS. However, as a Committee, we are equally concerned about pay for staff at all levels. We provide oversight and guidance on all RBS remuneration arrangements. In 2014 we are directing a greater proportion of our salary budget to our lower paid employees. We continue to pay our permanent employees in the UK at or above the "Living Wage" benchmarks (National and London) and intend to apply for full accreditation.

Our remuneration policy promotes transparency and accountability; pay is clawed back when things go wrong, and awards are suspended when investigations are ongoing. Clawback is a powerful tool and we have put it to use. This year we have suspended awards pending investigations triggered by serious allegations of misconduct. It is important for the company and the executives involved that discretionary awards are put on hold until all the facts are clear.

CRD IV
Many of you will be aware that a "bonus cap" has been introduced under the fourth European Capital Requirements Directive (CRD IV). Whilst the actual regulation and setting of a hard cap is not what we would have wished for, it is essentially aligned to our own actions to moderate pay levels and reduce pay leverage. We will therefore seek to comply with the spirit as well as the letter of the regulations.

We are considering whether to ask shareholders to approve a maximum ratio of variable to fixed pay at 2:1, rather than the default ratio of 1:1, at the 2014 AGM. As the legislation is now in force, we are reviewing how best to structure remuneration arrangements that are both compliant and aligned with shareholders' interests. The Board will agree its final position in light of emerging market practice and details of any proposals will be contained in the Letter to Shareholders prior to the AGM.

New Share Plan
At the 2014 AGM we will seek approval for the RBS 2014 Employee Share Plan. This will replace the Deferral Plan which expires in December 2014 and the Long Term Incentive Plan. Further details will be set out in the Letter to Shareholders.

Review of year and Group performance
Further progress was made in the run down of Non-Core during 2013. Our balance sheet and capital levels indicate how far RBS has come in building a safe and sustainable foundation. From a strategic point of view, progress was also made in re-shaping the Markets business, selling a further stake in Direct Line Group, agreeing a pre-IPO investment of the Williams and Glyn branches and bringing forward the IPO of Citizens. However, I won't shy away from the fact that overall it's been a tough year for RBS in terms of financial performance. Results in certain divisions have been disappointing and revenue growth is not what we would like it to be at this point in our recovery.

The regulatory landscape and increasing capital requirements have an impact on our returns to shareholders and, in turn, this must be reflected in our returns to employees. The Committee considers all these factors when determining appropriate reward levels.

Performance considerations for 2013
- Group Operating Profit, excluding the impact of RBS Capital Resolution (RCR) of £2,520 million, a reduction of 15% on 2012.

- Loss before tax of £8,243 million, due in part to the impact of RCR which will help to remove uncertainty associated with legacy issues.

- Markets division making strategic progress, staff costs are down 19% and RWAs are down 36%.
- Core Tier 1 capital ratio improved to 10.9% from 10.3% at the end of 2012.
- Reduction in Non-Core assets to £28 billion.
- RBS offered £58.5 billion of loans and facilities to UK businesses in 2013 of which £31.5 billion was to SMEs. RBS also helped UK companies, universities and housing associations to raise £24.7 billion through bond issues in 2013.
- Employee engagement is strong and clear evidence that key values are being embedded across the Group.

Decisions made on pay

- Full details of decisions for both current and former directors are set out in this report.
- Ross McEwan’s salary on appointment as Group Chief Executive represented a 17% reduction to his predecessor.
- In line with existing policy, Ross McEwan will receive a long-term incentive award in March 2014.
- Nathan Bostock has announced his departure and all outstanding share awards will lapse.
- Total compensation, both on an overall and per employee level, has been reduced for 2013.
- Total variable compensation reduced again for 2013, down 15% at a Group level and 17% for Markets compared to 2012. This includes a £25 million reduction as part of the committed LIBOR related actions.
- Total Group variable compensation as a percentage of operating profit (pre-RCR and before variable compensation), a key ratio, has remained at 19%.
- The proportion of deferred variable compensation delivered in shares has increased significantly for 2013, representing 63% for Group and 81% for Markets. Further details on the bonus pool can be found in Note 3 to the accounts on page 389.
- Incentive awards continue to be targeted towards high performers. 43% of employees who are eligible will not receive a bonus.

Directors' Remuneration Report

- Of those employees who do receive an award, 47% will receive £2,000 or less and 70% will receive less than £5,000.
- Any awards above £25,000 will be delivered 100% in shares and deferred over a three year period.
- Average salary increases made across the business in 2014 will be less than 2%.

In conclusion, I believe our decisions on pay take account of performance while giving us the flexibility to attract and retain the expertise needed to build for the future. The Committee continues to receive valuable and independent advice from PwC and I would like to thank my fellow Committee members and those who support the Committee for their insight and guidance during another eventful year. I am also greatly encouraged by the willingness of shareholders to engage constructively in the pay debate and grateful for their support.

Following the publication of the Parliamentary Commission on Banking Standards report in June 2013 and the announcement from the Prudential Regulation Authority (PRA) that they intend to consult on a revised Remuneration Code in 2014, it is likely that remuneration will continue to be an important part of the agenda facing banks in the year ahead. We welcome any developments that help to make banks safer and ensure fair returns for both shareholders and employees.

RBS is a major UK employer and, as a bank playing a key role in the economic recovery, we understand the importance of getting our pay decisions right. We are committed to a high level of transparency and I believe the new reporting and voting requirements that apply to this year's remuneration report can add to this process.

My closing message is simple. Pay must align with the long-term strategy and be cut when performance disappoints. This is what RBS is doing. I hope shareholders find this year's report helpful and feel able to support the proposals at the AGM.

Penny Hughes
Chair of the Group Performance and Remuneration Committee
26 February 2014

Directors' Remuneration Policy

Directors' Remuneration Policy
Future policy table for executive directors (EDs)

Fixed pay elements
To provide a level of competitive remuneration for performing the role with less reliance on variable pay in order to discourage excessive risk-taking and with partial delivery in shares to align with long-term shareholder value.

Element of pay	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics and period
Base salary	To aid recruitment and retention of high performing individuals whilst paying no more than is necessary. To provide a competitive level of fixed cash remuneration, reflecting the skills and experience required, and to discourage excessive risk-taking.	Paid monthly and reviewed annually. The rates for 2014 are as follows: Group Chief Executive - £1,000,000 Group Finance Director - £765,000 Further details on remuneration arrangements for the year ahead are set out on pages 85 to 87 of the annual report on remuneration.	Determined annually. Any future salary increases will be considered against peer companies and will not normally be greater than the average salary increase for RBS employees over the period of the policy.	No performance conditions are directly applicable although any future salary increases will take into account performance rating during the year.
Fixed share allowance	To provide fixed pay that reflects the skills and experience required for the role. This will be delivered in shares and held for the long term.	A fixed allowance, paid entirely in shares. Individuals will receive shares that vest immediately subject to any deductions required for tax purposes and a retention period will apply. Shares will be released in equal tranches over a five year period. The fixed share allowance will be paid in arrears, initially at six monthly intervals, and in the event of termination, only in respect of service completed(1).	An award of shares with an annual value of up to 100% of salary at the time of award. The fixed share allowance is not pensionable.	N/A
Benefits				N/A

	To provide a range of flexible and market competitive benefits to further aid recruitment and retention of key individuals.	A set level of funding is provided and EDs can select from a range of benefits including: · Company car · Private medical insurance · Life assurance · Ill health income protection Also entitled to use of a car and driver on company business and standard benefits such as holiday and sick pay. Further benefits including allowances when relocating from overseas may be provided to secure the most suitable candidate for the role.	Set level of funding for benefits (currently £26,250) which is subject to review. Further benefits such as relocation allowances and other benefits (e.g. tax advice, housing and flight allowances and payment of legal fees) may be offered in line with market. The value of benefits paid will be disclosed each year in the annual report on remuneration.	
Pension	To encourage planning for retirement and long-term savings.	Provision of a monthly cash pension allowance based on a multiple of salary. Opportunity to participate in a defined contribution pension scheme.	Pension allowance of 35% of salary.	N/A

Note:

(1) The company believes that delivery in shares is the most appropriate construct for a fixed allowance to executive directors, qualifying as fixed remuneration for the requirements imposed under CRD IV. If regulatory requirements emerge that prohibit any such allowances being delivered in shares, then the company reserves the right to provide the value of the allowance in cash instead in order to comply.

Directors’ Remuneration Policy

Variable pay
To further incentivise superior long-term performance, with rewards aligned with shareholders and adjusted for risk, based on the achievement of stretching performance measures.

Element of pay	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics and period
Variable pay award (long-term incentive)	To support a culture where good performance against a full range of measures will be rewarded. To incentivise the delivery of stretching targets in line with the Strategic Plan. The selection of performance metrics will be closely aligned with Key Performance Indicators. Performance is assessed against a range of financial and non-financial measures to encourage superior long-term value creation for shareholders. Delivery in shares with the ability to clawback further supports longer-term alignment with shareholders.	Any variable pay award made will be delivered in the form of a long-term incentive, paid in shares (or in other instruments if required by regulators) and subject to a combination of time deferral and performance-based requirements. A minimum three year performance period will apply. As a minimum, shares will be subject to deferral and retention periods as required under the PRA Remuneration Code. The award will have an overall five year vest period, vesting in equal tranches in years four and five. Provision for clawback prior to and post vesting of awards. The award will be delivered under the RBS 2014 Employee Share Plan, subject to shareholder approval at the 2014 AGM.	The maximum level of award is subject to any limit on the ratio of variable to fixed pay as required by regulators. If shareholder approval is sought and obtained at the 2014 AGM, this will be 200% of fixed pay (i.e. base salary, fixed share allowance, benefits and pension). For these purposes awards will be valued in line with the European Banking Authority rules, including any available discount for long-term deferral. Our intention is that awards for executive directors will be maintained at a maximum of 300% of base salary in line with past practice(1). The vesting level of the award could vary between 0% and 100% dependent on the	Any award made will be subject to future performance conditions over a minimum three year period. Typical measures may fall under the following categories (weighted 25% each): ·Economic Profit ·Relative Total Shareholder Return (TSR) ·Safe and Secure Bank ·Customers and People A financial and risk performance underpin provides discretion to vary the vesting outcome if the Committee considers this does not reflect underlying performance. These or similar measures and weightings will be applied to reflect the strategy going forward. Details of the award and performance measures for each year will be set out in the annual report on remuneration.

achievement of performance conditions. Between 20% - 25% will vest at threshold for each performance measure.

Note:
(1) In the event that shareholder approval is not sought or obtained for the 2:1 cap, corresponding adjustments will be made to ensure that executive directors remain within the variable to fixed limit.

Directors' Remuneration Policy

Other pay elements

Element of pay	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics and period
Shareholding requirements	To ensure EDs build and continue to hold a significant shareholding to align interests with shareholders.	A period of five years is allowed in which to build up shareholdings to meet the required levels. Any unvested share awards are excluded in the calculation.	Group Chief Executive - 250% of salary. Other EDs - 125% of salary. Requirements may be reviewed and increased in future.	N/A
All-employee share plans	An opportunity to acquire RBS shares.	Opportunity to contribute from salary to the RBS Sharesave and Buy As You Earn Plan.	Statutory limits imposed by HMRC.	N/A
Legacy arrangements	To ensure RBS can continue to honour payments due to EDs.	In approving this policy, authority is given to honour any previous commitments or arrangements entered into with current or former directors, including share awards granted under the 2010 Deferral Plan and 2010 Long Term Incentive Plan (LTIP) and awards granted prior to appointment as an executive director that may have different performance conditions aligned with divisional performance.	In line with existing commitments.	In line with existing commitments.

Notes to policy table

- The Committee sets performance targets taking into account the Group's Strategic Plan, financial forecasts and wider non-financial metrics. The performance conditions for variable pay awards made to EDs have been chosen to promote the building of a safer, stronger and more sustainable business. The Committee selects the measures each year after consultation with major shareholders.

- Clawback - An accountability review process is operated that allows the Committee to respond in instances where new information would change the variable pay decisions made in previous years and/or the decisions to be made in the current year. As a result, clawback can be applied to reduce or lapse any unvested awards as well as reducing any current year's variable pay. The Committee will also consider its approach to the operation of post vesting clawback in light of emerging market practice and regulatory requirements. Further details can be found on page 92.

- Remuneration for EDs broadly follows the policy for all employees but with greater emphasis on delivery in shares and a significant element of variable performance-related pay. This is to ensure that total remuneration to EDs is more aligned with the long-term interests of shareholders and dependent on specific performance measures being met. Further details on the remuneration policy for all employees can be found on page 91 and 92.

Changes for Executive Directors

- EDs will no longer be eligible to receive annual bonuses.

- The new structure outlined in the policy table introduces a fixed share allowance for EDs which will be released in equal tranches over a five year period. However, the Group Chief Executive will not receive a fixed share allowance for 2014.

- Future long-term incentive awards will be subject to an overall five year vest period, with a three year performance period and vesting in equal tranches in years four and five.

- The new structure results in a reduction of 16% of maximum remuneration opportunity, maintaining significant exposure to shares and clawback but with increased holding periods.

- The policy reflects our objective of moderating total remuneration while providing strong alignment with shareholders over the longer-term.

Directors' Remuneration Policy

Fees for non-executive directors

Element of pay	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics and period
Fees	To provide a competitive level of fixed remuneration that reflects the skills, experience and time commitment required for the role. No variable pay is provided so that non-executive directors can maintain appropriate independence, focus on long-term decision making and constructively challenge performance of the executive directors.	Fees are paid monthly. The level of remuneration for non-executive directors reflects their responsibility and time commitment and the level of fees paid to directors of comparable major UK companies. Non-executive directors do not participate in any incentive or performance plan. Non-executive directors' fees are reviewed regularly.	The rates for the year ahead are set out in the annual report on remuneration on page 85 Any future increases to fees will be considered against non-executive directors at comparable companies and will not normally be greater than the average inflation rate over the period under review, taking into account that any change in responsibilities, role or time commitment may merit a larger increase. Fees have not yet been set for the recently established RCR Board Oversight Committee. Our policy is that additional fees may be paid for new Board Committees provided these are not greater than fees payable for the existing Board Committees as detailed in the annual report on remuneration.	N/A
Benefits	Any benefits offered would be in line with market practice.	Reimbursement of reasonable out-of-pocket expenses incurred in performance of duties. The Chairman	The value of the private medical cover provided to the Chairman will be in line with market rates and disclosed in the	N/A

also receives private medical cover in line with the scheme rules.	annual report on remuneration.

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Directors' Remuneration Policy

Policy start date

The remuneration policy will be effective from the date of the 2014 AGM, subject to shareholder approval. It is intended that the policy will apply for three years unless changes are required in which case a revised policy will be submitted to shareholders for approval.

Recruitment remuneration policy

- The approach to recruitment of directors is to consider both internal and external candidates and to pay no more than is required to attract the most suitable candidate for the role.

- The policy on the recruitment of new directors aims to structure pay in line with the framework and quantum applicable to current directors, competitive in a market context and including the components detailed in the policy table, taking into account that some variation may be necessary to secure the preferred candidate.

- Consideration will be given to the skills and experience held by the individual being recruited as well as the incumbent's position. The present circumstances of the company will also be taken into account.

- In the event of an internal promotion, existing contractual commitments can continue to be honoured.

- Any awards granted on recruitment may be made as part of the company's share plans from time to time or under the provisions provided by Section 9.4.2 of the Listing Rules and will need to comply with the requirements of the PRA Remuneration Code. No sign-on awards or payments will be offered over and above the normal buy-out policy to replace awards forfeited or payments foregone. The Committee will seek to minimise buy-outs wherever possible and will seek to ensure they are no more generous than, and on substantially similar terms to, the original awards or payments they are replacing.

- The maximum level of variable pay which may be granted to new executive directors is the same as that applicable to existing executive directors, excluding any buy-out arrangements. Non-executive directors do not receive variable pay. Full details will be disclosed in the next remuneration report following recruitment.

Discretion

The Committee has certain discretions that allow it, in appropriate circumstances, to vary the remuneration provided to directors. For example, under the LTIP rules and also the proposed RBS 2014 Employee Share Plan, the Committee can determine: whether a leaver would fall into circumstances that would allow awards to vest following leaving; to decide to vest earlier than the normal vesting date; and to vary the pro-rating for time elapsed that would normally apply. Such discretions would only be used in exceptional circumstances to ensure a fair outcome for the director and for shareholders, taking into account the circumstances of departure, the performance of the director and the need to ensure an orderly transition. If discretion is applied in these circumstances then it will be disclosed.

Further discretions include the ability to: treat awards in a range of ways in the event of a change of control; change measures, targets, and adjust awards if major events occur (for example transaction and capital raisings); and make administrative changes to the plan rules.

In addition, the Committee retains discretion to apply clawback to awards and also adjust the vesting outcome in relation to certain long-term incentive awards through the application of a risk underpin. This allows the Committee to reduce or lapse awards if it considers that the vesting outcome does not reflect underlying financial results or if it considers that the results have been achieved with excessive risk.

Consideration of employment conditions elsewhere in the company

The Committee retains oversight of remuneration policy for all employees to ensure there is a fair and consistent approach throughout the organisation. This includes the use of deferral and clawback to promote effective risk management and alignment with shareholders. Further details on our remuneration policy for all employees are set out on pages 91 and 92.

While employees are not directly consulted on setting directors' remuneration, consultation on remuneration generally takes place with our social partners, including representatives from UNITE. We continue to pay our permanent employees in the UK at or above the "Living Wage" benchmarks (National and London), and intend to apply for full accreditation. An annual employee opinion survey takes place which includes a number of questions on pay and culture. This includes questions as to whether employees believe they are paid fairly for the work they do, how remuneration at RBS compares to other financial services organisations and how good a job the organisation is doing in matching reward to performance.

Around 34,000 of our employees are shareholders through incentive and all-employee share plans and have the ability to express their views through voting on the Directors' Remuneration Report.

Directors' Remuneration Policy

Service contracts and policy on payments for loss of office – directors		
Provision	Policy	Details
Payments for loss of office	Payment in lieu of notice only	If either party wishes to terminate an executive director's service contract they are required to give 12 months' notice to the other party. The service contracts do not contain any pre-determined provisions for compensation on termination. The service contracts give RBS the discretion to make a payment in lieu of notice, which is on base salary only (with no payment in respect of any other benefits, including pension) and is released in monthly instalments. During the period when instalments are being paid, the executive director must take all reasonable steps to find alternative work and any remaining instalments will be reduced as appropriate to offset income from any such work.
Treatment of annual and long-term incentives on termination	Treatment in line with the relevant plan rules as approved by shareholders	Existing annual incentive awards under the Deferral Plan will not normally lapse on termination, unless termination is for Cause (as defined in the rules of the Deferral Plan). The awards will normally continue to vest on the original vesting dates, subject to provisions regarding clawback, competitive activity and detrimental activity. Existing long-term incentive awards normally lapse on leaving unless the termination is for one of a limited number of specified 'good leaver' reasons or the Committee exercises its discretion to prevent lapsing. The Committee may exercise this discretion where it believes this is an appropriate outcome in light of the contribution of the participant and shareholders' interests. Where awards do not lapse on termination, any vesting will normally take place on the original vesting dates, subject to the performance conditions being met and pro-rating to reflect the proportion of the period that has elapsed at the date of termination. Clawback provisions will also apply. These provisions will also apply to variable remuneration delivered under the RBS 2014 Employee Share Plan, subject to shareholder approval at the 2014 AGM.
Fixed share allowances	Treatment in line with the plan rules as approved by shareholders	Any shares already received under fixed share allowances will not be forfeited on termination but must continue to be held for the original retention periods. In leaver circumstances executive directors will also be eligible to receive a pro-rated fixed share allowance.

Other provisions	Standard contractual terms in line with market practice	Contracts include standard clauses covering remuneration arrangements and discretionary incentive plans (as set out in the main policy table above), reimbursement of reasonable out-of-pocket expenses incurred in performance of duties, redundancy terms and sickness absence, the performance review process, the disciplinary procedure and terms for dismissal in the event of personal underperformance or breaches of RBS policies.
Other payments	Discretionary	The Committee retains the discretion to make payments (including but not limited to professional and outplacement fees) to mitigate against legal claims, subject to any payments being made pursuant to a settlement or release agreement.
Provisions for non-executive directors (NEDs) and the Group Chairman		NEDs do not have service contracts or notice periods although they have letters of engagement reflecting their responsibilities and time commitments. No compensation would be paid to any NED in the event of termination of appointment. Arrangements for the Chairman Philip Hampton is entitled to receive a cash payment in lieu of notice of 12 months' fees in the event that his appointment is terminated as a result of the majority shareholder seeking to effect the termination of his appointment, or if RBS terminates his appointment without good reason, or if his re-election is not approved by shareholders in General Meeting resulting in the termination of his appointment.

In accordance with the provisions of the UK Corporate Governance Code, all directors of the company stand for annual election or re-election by shareholders at the company's Annual General Meetings.

Directors' Remuneration Policy

Illustration of the potential application of the remuneration policy

- Salary + Benefits + Pensions delivered in cash. The benefits include standard benefit funding as outlined in the policy but exclude exceptional items such as relocation allowances, the value of which will be disclosed in the total remuneration table each year.

- Fixed share allowance = an allowance of 100% of salary, paid in shares and released in equal tranches over a five year period.

- Target = Fixed remuneration and assuming payout of long-term incentive vesting at 45% of maximum (135% of salary).

- Maximum = Fixed remuneration and assuming full payout of long-term incentive vesting at 300% of salary.

- The graphs above illustrate the application of policy to executive directors for the first full year as the Group Chief Executive will not receive a fixed share allowance in 2014.

The charts shown above are for illustration only and do not take into account any share price movement. Any value receivable in respect of long-term incentive awards will depend on performance over the period and the share price when the holding period comes to an end.

Shareholders views and their impact on remuneration policy

An extensive consultation is undertaken every year with major shareholders including UKFI and other stakeholders on our remuneration approach. The consultation process typically involves inviting our largest shareholders to attend either one-to-one meetings or roundtable sessions with relevant shareholder bodies. A range of topics are discussed including intended remuneration policy for the year ahead and any significant changes. The process takes place in sufficient time for shareholder views to be considered prior to the Committee making any final decisions on remuneration and variable pay awards. Details of shareholder voting on the resolution to approve the last remuneration report can be found in the annual report on remuneration.

In late 2013 and early 2014, meetings took place involving around 20 institutional shareholders and shareholder bodies representing a substantial portion of the non-UKFI shareholding. The topics discussed during the latest consultation included financial performance, determination of pay outcomes for the 2013 performance year, the Board changes, the impact of CRD IV and possible pay arrangements going forward. Shareholders asked wide-ranging questions including the ability to remain market competitive, the accountability review process, retaining and motivating employees through periods of change and the use of performance measures for long-term incentive awards.

The reaction to the consultation process was positive and allowed the Committee to gain valuable insight into areas that shareholders were likely to support and those areas of concern. There was general support for the possible use of role-based allowances for the small number of employees impacted by the cap imposed under CRD IV. Payment of any allowances in arrears, with delivery in shares for more senior roles and with deferral, were viewed as positive features. Many shareholders also welcomed the discontinuation of annual bonus arrangements for executive directors but stressed the need to ensure sufficient variable pay was available for performance adjustment and clawback. The move to a five year overall timeframe for future long-term incentive awards was also viewed favourably. Overall, there was continuing support for simple and transparent pay structures.

A number of shareholders cautioned that legal advice should be obtained to confirm that the proposed pay arrangements complied with the requirements of CRD IV. The Committee responded to these concerns by obtaining independent legal advice. Another theme from shareholders was that there should be a demonstrable reduction in remuneration to reflect the benefits of pay certainty for the participants.

Some shareholders asked for the level of reduction in total compensation opportunity and rationale to be clearly explained. As set out in this report, annual bonus awards have been discontinued for executive directors. A fixed share allowance will be introduced that will deliver up to 100% of salary in shares to be released in equal tranches over a five year period. The new structure results in a reduction of 16% of maximum remuneration opportunity and still maintains alignment in shares and with longer holding periods.

Shareholders continue to play a vital role in developing remuneration practices that support the long-term interests of the business and the Committee is grateful and greatly encouraged by their involvement in the process.

Annual report on remuneration

Total remuneration paid to directors

The sections as indicated on pages 79 to 84 have been audited.

Total remuneration for executive directors (£000s) (audited)

	Former directors				Current directors			
	Stephen Hester (1)		Bruce Van Saun (2)		Ross McEwan (3)		Nathan Bostock (3)	
	2013	2012	2013	2012	2013	2012	2013	2012
Salary	900	1,200	570	750	250	—	191	—
Benefits (4)	20	26	74	134	40	—	7	—
Pension	315	420	348	436	88	—	67	—
Annual bonus	—	—	—	980	—	—	—	—
LTIP (5)	—	—	—	—	—	—	—	—
Total remuneration	1,235	1,646	992	2,300	378	—	265	—

Notes:

(1) Stephen Hester stepped down from the Board on 30 September 2013 and did not receive any annual bonus entitlement for the 2013 performance year. See page 82 for details of termination arrangements and payment in lieu of notice.

(2) Bruce Van Saun stepped down from the Board on 30 September 2013 to become CEO and Chairman of RBS Citizens Financial Group and Head of RBS Americas. Mr Van Saun also stepped down as a non-executive director of Direct Line Insurance Group plc and Worldpay (Ship Midco Limited), for which he did not receive any fees. He is a non-executive director of Lloyd's of London Franchise Board for which he received fees of £51,750 for the period to 30 September 2013. The amounts included in the table in respect of Mr Van Saun's pension relates to contributions that would have been made to his Unfunded Unapproved Retirement Benefit Scheme ("UURBS") (if it had been funded) comprising a pension allowance of 35% of salary, together with additional amounts through a salary sacrifice arrangement plus an investment return at a rate of 4.7% for 2013 (6.2% for 2012).

(3) Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013 and the table reflects their pay for the period as Group Chief Executive and Group Finance Director respectively since appointment.

(4) Benefits figure includes standard benefit funding of £26,250 per annum with the remainder being relocation expenses provided to Bruce Van Saun (housing allowance) and Ross McEwan (housing and flight allowances).

(5) The zero value reflects awards granted to executive directors under the Long-term Incentive Plan in 2010 that did not vest in May 2013. See page 81 for details of subsequent LTIP assessments.

Chairman and non-executive directors' remuneration (£000s) (audited)

Remuneration of non-executive directors, excluding the Chairman, was reviewed in 2013. Basic board fees were last increased in 2008 and Committee fees were last increased in 2010. It was recognised that time commitment at RBS had increased significantly over the period. This increased time commitment was due to a number of factors including an intense regulatory agenda, the extended remit of Board Committees, wider engagement with the business and the executive team and efforts to drive cultural change. Consideration was also given to evidence of market increases in Board fees over the period. For the current non-executive directors, the Board, excluding non-executive directors, approved a revised fee structure applicable from 1 April 2013 as set out on page 85.

	Board and	Benefits and	2013 Total	2012 Total

	Committee fees	other fees		
Philip Hampton (1)	750	1	751	750
Sandy Crombie	186	—	186	150
Alison Davis	132	—	132	114
Tony Di Iorio (2)	136	—	136	128
Robert Gillespie (3)	7	—	7	n/a
Penny Hughes	154	—	154	150
Brendan Nelson	164	—	164	150
Baroness Noakes	136	—	136	124
Philip Scott	164	—	164	150
Former non-executive directors				
Joe MacHale (4)	49	—	49	133
Art Ryan (5)	80	—	80	93

Notes

(1) Philip Hampton is entitled to private medical cover and the value is shown in the benefits column.

(2) Tony Di Iorio became a non-executive director of RBS Citizens Financial Group, Inc on 15 January 2014, the fees for which will be reported in future years.

(3) Robert Gillespie was appointed to the Board with effect from 2 December 2013.

(4) Joe MacHale retired from the Board with effect from 14 May 2013. Board Committee fee included membership of the Asset Protection Scheme Senior Oversight Committee.

(5) Art Ryan is a non-executive director of RBS Citizens Financial Group, Inc. for which he received fees of US$131,000 for the period to 30 September 2013, the date he retired from the Group Board.

There have been no payments made to non-executive directors for loss of office.

Annual report on remuneration

Total Pension Entitlements – Bruce Van Saun (audited)

Mr Van Saun's UURBS operates as a cash balance plan. The rate of return on the accrued fund is determined annually by the Committee to reflect a long-term low risk investment return on an unsecured basis. For 2013 this rate was 4.7%. His accrued entitlement at the year end is shown below. There is no provision for any additional benefit on early retirement.

	2013 £000s	2012 £000s
Balance at 1 January 2013	682	246
Aggregate contributions that would have been made if funded	306	408
Investment return	42	28
Total value of fund at 31 December 2013	1,030	682

Executive directors' annual bonus for 2013 (audited)

The normal maximum that could be paid to executive directors under the annual bonus arrangements for 2013 is 200% of salary. The table below sets out the outcome for the 2013 performance year.

Stephen Hester

As part of the exit arrangements detailed on page 82, no annual bonus award is payable to Stephen Hester for 2013.

Bruce Van Saun

As announced on 27 January 2014, no bonus award will be payable to executive directors or members of the 2013 Executive Committee in respect of 2013 performance.

Ross McEwan

Ross McEwan indicated he did not wish to be considered for an annual bonus in respect of his Group Chief Executive role in 2013 or 2014. As announced on 27 January 2014, no bonus award will be payable in respect of the UK Retail role that Mr McEwan undertook during 2013.

Nathan Bostock

Following announcement of his departure, no annual bonus is payable to Nathan Bostock.

Executive directors' LTIP awards granted in 2010 – final assessment of performance outcome (audited)

Performance measure	Performance requirements	Vesting outcome
Economic profit (50%)	Maximum vesting triggered by early delivery of Core business profitability, well ahead of the range implied by the published Strategic Plan targets and also in excess of the cost of capital.	The LTIP awarded in 2010 was due to vest in May 2013. The number of shares under award is set out in the table on page 83. Awards did not vest in May 2013 as a result of the threshold performance requirements not being met and the awards lapsed.
Relative TSR (25%)	20% vesting if TSR is at the median rising to 100% vesting if TSR is at the upper quartile of the companies in the comparator group.	
Absolute TSR (25%)	20% vesting if RBS share price reaches £5.75. 100% vesting if RBS share price reaches £7.75.	

Share plan interests awarded under the LTIP during 2013 (audited)

	Grant date	Face value of	Performance

		award (£000)	Number of shares awarded	% that would vest at threshold and maximum	requirements
Stephen Hester	8 March 2013	3,600	1,164,295	Vesting between 0% - 100% with 20% - 25% vesting at threshold	Conditional share awards subject to stretching performance conditions over a three year period ending on the third anniversary of the grant date, as detailed below.
Bruce Van Saun	8 March 2013	2,250	727,685		
Ross McEwan	8 March 2013	2,153	696,152		The LTIP award granted to Ross McEwan will be assessed based on 12 months against the targets applicable as CEO UK Retail and 24 months against the targets applicable as Group Chief Executive.
Nathan Bostock	8 March 2013	2,500	808,539		

Notes:
The number of shares awarded is based on a multiple of salary and the award price is calculated based on the average share price over five business days prior to the grant date of £3.092
In addition to performance conditions, all awards are subject to clawback provisions prior to vesting and a six month retention period post vesting in line with the PRA Remuneration Code.
The treatment of outstanding LTIP awards held by Stephen Hester is detailed under the Payments for loss of office section.
The LTIP award held by Nathan Bostock has been lapsed following notification that he will be leaving the Group.

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Annual report on remuneration

Performance conditions for outstanding LTIP awards granted to executive directors in 2011, 2012 and 2013 – current assessment

Awards are due to vest in 2014 to 2016. An assessment of performance of each relevant element is provided by the control functions and PwC assesses relative TSR performance. The Committee determines overall vesting based on these assessments including consideration of the drivers of performance and the context against which it was delivered. The assessment is analytical and if any discretion is used in the final assessment, it will be explained. The table below represents an early indication of potential vesting outcomes only.

Performance measure	Weighting	Rationale	Vesting	2011 LTIP Current assessment of performance	2012 and 2013 LTIP Current assessment of performance
Core Bank economic profit	25%	Ensures that performance reflects risk adjusted enduring earnings.	Threshold: 25% vesting for meeting minimum economic profit targets. Maximum: 100% vesting for performance ahead of the Strategic Plan.	Continued difficult conditions mean that the economic profit target has not been met.	Excluding the impact of the 2013 RCR action performance is currently broadly in line with expectations. The Committee notes the impact of the RCR impairment and will determine at the point of vesting how this should be taken into account.
Relative TSR	25%	Ensure alignment with shareholders.	Threshold: 20% vesting if TSR is at median of the comparator group. Maximum: 100% vesting if TSR is at upper quartile of the comparator group. Pro rata vesting in between.	Based on share price performance up to 31 December 2013, the threshold target is unlikely to be met by the vesting date.	Based on share price performance up to 31 December 2013, the threshold targets have not yet been met.
Balance sheet and risk	25%	Ensure alignment with the advancement of the strategic position and capability of the organisation and	Vesting will be qualified by Committee discretion. Indicative vesting levels are:	All targets – including Non-Core run down, Core Tier 1 capital, wholesale funding, liquidity, leverage ratio, loan to deposit ratio and funded	Majority of Balance Sheet and Risk measures are currently on track or ahead of target.

Strategic Scorecard	25%	the building of a sustainable business.	· Over half of objectives not met: 0%; · Half of objectives met: 25%; · Two-thirds of objectives met: 62.5%; and · Objectives met or exceeded in all material respects: 100%.	assets - have been met or exceeded. Credit rating condition was not met, but given over-achievement on other measures, the Committee determined that the Balance Sheet and Risk element would vest in full. For the Strategic Scorecard, the cost:income ratio target has been missed driven by income shortfall. Overall the Committee determined that fewer than half of the objectives have been met and also took into account the extent of the shortfall on cost:income ratio and determined that this element should not vest.	Cost:income ratio remains challenging to achieve largely due to market-driven income pressures. Positive performance to date on some of the other Strategic Scorecard measures would result in some level of vesting for this element if continued over the performance period.

In respect of the 2011 LTIP award which is due to vest on 7 March 2014, the latest performance assessment by the Committee indicates a vesting level for executive directors of 27% of the original number of shares under award. The Committee also received advice that BRC and the Group’s risk management function is satisfied that risk performance of the Group has adversely impacted the Economic Profit and TSR outcomes and consequently no further adjustment is required to the proposed vesting level.

Annual report on remuneration

Payments to past directors (audited)
No payments were made to former directors during the year ended 31 December 2013.

Payments for loss of office (audited)
Stephen Hester
Stephen Hester stepped down from the Board on 30 September 2013 and, in line with his contractual arrangements, he received the following payments in lieu of 12 months' notice.

Salary	£1,200,000
Benefits	£26,244
Pension	£420,000
Total	£1,646,244

Stephen Hester also received payment in lieu of five days accrued holiday, a nominal amount (£100) in respect of an undertaking to provide ongoing assistance to RBS with any investigations or claims and a commitment to pay directly to his lawyers legal fees of £23,000 + VAT incurred in connection with his departure. He did not receive any annual bonus award for 2013.

The Committee exercised discretion under the LTIP rules to allow unvested awards to continue subject to time pro-rating and performance assessment. The Committee believed this was an appropriate use of discretion in the circumstances recognising the significant contribution made by Stephen Hester over the period and his willingness to assist in an orderly handover period. The performance conditions will be assessed by the Committee at the end of the relevant performance periods in line with the LTIP rules. Stephen Hester and the Committee agreed that the maximum number of shares available for vesting under outstanding LTIP awards would be capped at 65% after the application of time pro-rating. The maximum number of shares available for vesting is therefore as follows:

Unvested LTIP shares at departure	3,461,886
Shares remaining after time pro-rating	2,064,638
Max number of time pro-rated shares capped at 65% (1)	1,342,014

Note:
(1) The actual number of shares will depend on performance assessment and may be less.

Bruce Van Saun
Bruce Van Saun stepped down from the Board on 30 September 2013 and became CEO and Chairman of RBS Citizens Financial Group and Head of RBS Americas. He continues to be employed within RBS and therefore no termination payment was made in connection with this change of role.

Directors' interests in shares and shareholding requirements (audited)
The target shareholding level for the Group Chief Executive is 250% of salary and 125% of salary for other executive directors and members of the Executive Committee, in each case excluding any unvested share awards in the calculation. A period of five years is allowed in which to build up shareholdings to meet the required levels.

As at 31 December 2013 (or date of cessation if earlier)			
	% of issued	Value(1)	

	Shares beneficially owned	share capital	(£)	% of shareholding requirement met	Unvested LTIP awards (subject to performance conditions)	Unvested Deferral Plan awards
Stephen Hester	761,218	0.01227	2,740,385	91%	2,064,638	—
Bruce Van Saun	148,421	0.00239	501,663	49%	2,163,680	466,947
Ross McEwan	516,336	0.00832	1,745,216	70%	1,259,081	56,395
Nathan Bostock	375,969	0.00606	1,270,775	133%	2,151,234	289,536
Philip Hampton	27,630	0.00045		n/a		
Sandy Crombie	20,000	0.00032		n/a		
Alison Davis	20,000	0.00032		n/a		
Tony Di lorio (2)	30,000	0.00048		n/a		
Robert Gillespie	nil	—		n/a		
Penny Hughes	562	0.00001		n/a		
Joe MacHale	28,431	0.00046		n/a		
Brendan Nelson	12,001	0.00019		n/a		
Baroness Noakes	21,000	0.00034		n/a		
Art Ryan	5,000	0.00008		n/a		
Philip Scott	50,000	0.00081		n/a		

Notes:

(1) Value is based on the share price at 31 December 2013, which was £3.38 other than for Stephen Hester where the value is based on the share price of £3.60 at 30 September 2013, the date he stepped down from the Board. During the year ended 31 December 2013, the share price ranged from £2.66 to £3.85.

(2) Tony Di Iorio’s interests in the company’s shares are held in the form of American Depository Receipts (ADRs). Each ADR represents 2 ordinary shares of £1.00 each in the company. Tony Di Iorio has interests in 15,000 ADRs representing 30,000 ordinary shares

In line with the requirements of the PRA Remuneration Code and the RBS Staff Dealing Rules, executive directors must not engage in any personal hedging strategies to lessen the impact of a reduction in value of unvested share awards, for example if the RBS share price goes down. No other current director had an interest in the company's ordinary shares during the year or held a non-beneficial interest in the shares of the company at 31 December 2013, at 1 January 2013 or date of appointment if later. The interests shown above include connected persons of the directors. As at 26 February 2014, there were no changes to the directors' interests in shares shown in the table above.

Annual report on remuneration

Directors' interests under the Group's share plans (audited)

Long-Term Incentive Plan (LTIP) awards

Awards to executive directors under the LTIP are structured as conditional rights to receive shares and are subject to performance conditions and clawback provisions prior to vesting.

	Awards held at 1 January 2013 (or date of appointment if later)	Awards granted in 2013	Award price £	Awards lapsed in 2013	Awards held at 31 December 2013 (or date of cessation)	End of period for qualifying conditions to be fulfilled
Stephen Hester (2)	857,843		4.90	857,843	—	—
	1,011,417		4.45	56,189	955,228	07.03.14
	1,286,174		2.80	500,179	785,995	09.03.15
		1,164,295	3.09	840,880	323,415	08.03.16
	3,155,434	1,164,295		2,255,091	2,064,638(1)	
Bruce Van Saun (2)	518,280		4.90	518,280	—	—
	632,136		4.45		632,136	07.03.14
	803,859		2.80		803,859	09.03.15
		727,685	3.09		727,685	08.03.16
	1,954,275	727,685		518,280	2,163,680	
Ross McEwan (3)	562,929		2.14		562,929(4)	07.06.14 -07.08.15
	696,152		3.09		696,152	08.03.16
	1,259,081				1,259,081	
Nathan Bostock (3,5)	449,519		4.45		449,519	07.03.14
	893,176		2.80		893,176	09.03.15
	808,539		3.09		808,539	08.03.16
	2,151,234				2,151,234	

Deferred awards

Awards are structured as conditional rights to receive shares under the RBS 2010 Deferral Plan and are subject to clawback prior to vesting.

	Awards held at 1 January 2013 (or date of appointment if later)	Awards granted in 2013	Award price £	Awards vested in 2013	Market price on vesting £	Value on Vesting £	Awards held at 31 December 2013 (or date of cessation)	End of period for qualifying conditions to be fulfilled
Stephen Hester	229,254		4.45	229,254	3.06	701,517	—	—
Bruce Van Saun	151,544		4.45	151,544	3.06	463,725	—	—
	300,000		2.80	150,000	3.06	459,000	150,000	09.03.13 – 09.03.14

			(6)						08.03.14 –
		316,947		3.09				316,947	08.03.15
	451,544	316,947			301,544			466,947	
									08.03.14 -
Ross McEwan	56,395			3.09				56,395	08.03.16
	454,106			2.14	454,106	3.40	1,543,960	—	—
	510,501				454,106			56,395	
Nathan Bostock(5)	28,657			4.45				28,657	07.03.14
									09.03.14 -
	125,045			2.80				125,045	09.03.15
									08.03.14 -
	135,834			3.09				135,834	08.03.16
	289,536							289,536	

Notes:
(1) Stephen Hester and the Committee agreed that the maximum number of shares available for vesting would be capped at 65% (a total of 1,342,014 shares). The actual number of shares will depend on the performance assessment and may be less.
(2) Stephen Hester and Bruce Van Saun stepped down from the Board on 30 September 2013.
(3) Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013.
(4) This relates to an award made to Ross McEwan on joining RBS as CEO UK Retail in September 2012, in recognition of awards forfeited on leaving Commonwealth Bank of Australia.
(5) In accordance with the plan rules, Nathan Bostock's outstanding LTIP, Deferred awards and MPP award have subsequently been lapsed and the Executive Share Option will lapse on his final date of employment.
(6) This relates to a bonus award in respect of the 2012 performance year, awarded in March 2013.

Annual report on remuneration

Share options

	Share Plan	Options held at 1 January 2013 (or date of appointment if later)	Number of options lapsed in 2013	Option price £	Options held at 31 December 2013 Number	Exercise period
Nathan Bostock (5)	Executive Share Option Plan	207,467	—	4.62	207,467	17.08.12 – 16.08.19
	Sharesave Plan	3,556	3,556	4.34	—	—
		211,023	3,556		207,467	

Medium-Term Performance Plan (MPP)

	Scheme interests (nil cost option) at 1 January 2013 (or date of appointment if later)	Award price £	Awards exercised in 2013	Scheme interests (share equivalents) at 31 December 2013	End of period for qualifying conditions to be fulfilled
Nathan Bostock (5)	117,809	4.52	—	117,809	17.08.12

For the notes to this table refer to the previous page.

Total Shareholder Return (TSR) performance

The graph below shows the performance of RBS over the past five years in terms of TSR compared with that of the companies comprising the FTSE 100 Index. This index has been selected because it represents a cross-section of leading UK companies. The TSR for FTSE UK banks for the same period has been added for comparison. The TSR for the company and the indices have been rebased to 100 at 1 January 2009. Source: Datastream

Historic Group Chief Executive pay over same period

	2009	2010	2011	2012	2013(1)
Group Chief Executive single figure of	1,647	3,687	1,646	1,646	1,235 (SH)
total remuneration (£000s)	—	—	—	—	378 (RM)
Annual variable award	0%	85%	0%	0%	0% (SH)
against max opportunity	—	—	—	—	0% (RM)
LTIP vesting rates	0%	0%	0%	0%	0% (SH)
against max opportunity	—	—	—	—	0% (RM)

Note:

(1) Stephen Hester (SH) stepped down from the Board on 30 September 2013 and Ross McEwan (RM) became Group Chief Executive with effect from 1 October 2013.

Change in Group Chief Executive pay compared to employees

The table below shows the percentage change in remuneration for the Group Chief Executive between 2013 and 2012 compared with the percentage change in the average remuneration of RBS employees on a global basis. In each case, remuneration is based on salary, benefits and annual bonus. The Group Chief Executive remuneration reflects the change in remuneration arrangements for the new Group Chief Executive with effect from 1 October 2013 compared to the previous Group Chief Executive.

	Salary 2013 to 2012 change	Benefits 2013 to 2012 change	Annual Bonus 2013 to 2012 change
Group Chief Executive	(16.7%)	—	—
All employees	2.1%	2.1%	(16.6%)

Note:

(1) No bonus was paid to the Group Chief Executive in respect of 2012 or 2013 performance. Standard benefit funding for executive directors remained unchanged between 2012 and 2013. The benefits for the Group Chief Executive excludes the relocation expenses provided to Ross McEwan as part of his recruitment as CEO UK Retail in 2012 and which will last for a set three year period other than an entitlement to two return business class flights which applies from year three onwards. The value of relocation benefits will be disclosed each year in the total remuneration table.

Annual report on remuneration

Relative importance of spend on pay

The table below shows a comparison of remuneration expenditure against other disbursements.

	2013 £m	2012 £m	change
Remuneration paid to all employees (1)	6,371	7,231	(12%)
Distributions to holders of ordinary shares	—	—	—
Distributions to holders of preference shares	398	301	32%
Taxation and other charges recognised in the income statement:			
- Social security and other payments (2)	486	562	(14%)
- Bank levy	200	175	14%
- Corporation tax	382	441	(13%)
Other payments made by the Group			
- Irrecoverable VAT and other indirect taxes suffered by the Group (3)	714	830	(14%)

These measures have been included as they reflect the key stakeholders for the Group and the major categories of disbursements made by the Group to its key stakeholders, including its ordinary and preference shareholders and Governments in the Group's operational territories.

The amounts included above have been calculated in accordance with applicable accounting standards and reflect the amounts included in the Group Income statement and related Notes.

Notes:
(1) Remuneration paid to all employees represents total staff expenses per Note 3 to the Financial statements, exclusive of social security and other staff costs.
(2) Income statement charge for social security costs per Note 3 to the Financial Statements.
(3) Input VAT and other indirect taxes unable to be recovered by the Group due to it being partially exempt.

Implementation of remuneration policy in 2014

The information below sets out how RBS intends to implement the policy in 2014.

Executive directors

	Salary	Benefits	Pension	Fixed Share Allowance (1)	LTIP award
Group Chief Executive	£1,000,000	£26,250 + relocation benefits (3)	35% of salary	No award in 2014	300% of salary
Group Finance Director (2)	£765,000	£26,250	35% of salary	100% of salary	300% of salary

Notes:
(1) Fixed Share Allowance will be payable in arrears and the shares will be released in equal tranches over a five year period.
(2) The search for a new Group Finance Director is underway and the remuneration package will be consistent with the recruitment policy as set out on page 76.
(3)

Relocation benefits include housing and flight allowances, the value of which will be disclosed each year in the total remuneration table.

Chairman and non-executive directors' fees

Chairman	£750,000
Non-executive Director Group Board	£72,500
Senior Independent Director	£30,000
Membership of Group Audit Committee, Board Risk Committee, Group Performance and Remuneration Committee or Group Sustainability Committee	£30,000
Additional fee to Chair the Group Audit Committee, Board Risk Committee, Group Performance and Remuneration Committee or Group Sustainability Committee	£30,000
Membership of Group Nominations Committee	£5,500

The non-executive directors do not receive any annual bonus payments or variable remuneration.

Annual report on remuneration

2014 Annual objectives for the Group Chief Executive and Group Finance Director

The executive directors' annual objectives, as set out below, are approved by the Committee and reflect the Group's key strategic priorities. The Board Risk Committee has approved the risk and control issues. Note that, as described in the Remuneration Policy section of the report, no annual bonus awards will be payable to executive directors. Nevertheless, the Committee believes that annual objectives are an important part of driving the business strategy and meeting agreed targets.

Core objectives	Summary of objectives and targets (1)
Customer & Stakeholder (25%)	· Customer Strategy and Experience - clearly articulate customer strategy; effective customer experience framework and measurement approach. · Customer Relationships - develop stronger and deeper customer relationships. · Corporate reputation - enhance and support the company's reputation with all stakeholders.
Financial & Business Delivery (25%)	· Common Equity Tier 1 Ratio - deliver fully loaded Common Equity Tier 1 ratio in line with strategic targets, including successful execution of RCR reduction. · Return on Equity (2) - improve return on equity through reduction of cost:income ratio; deliver income growth in line with strategic targets. · Cost:Income Ratio (2) - reduce cost:income ratio in line with strategic targets.
People & Culture (25%)	· Operating Model - deliver first phase of efficient and effective bank-wide operating model. · Values & Engagement - embed and role model the Group's values, setting the tone from the top, and building the pride and engagement of our people. · Diversity - promote gender diversity in senior talent pools.
Risk & Control (25%)	· Risk Appetite - further progress on embedding enhanced risk appetite and risk frameworks. · Governance & Control - maintain an effective control environment and deliver key systems and processes. · Conduct - embed the agreed conduct risk framework across the business. · End to End Risk Management Framework - maintain an effective risk management framework across the business.

Notes:
(1) Details of targets that are deemed to be commercially sensitive will be disclosed retrospectively.
(2) Excluding RBS Capital Resolution.

Annual report on remuneration

LTIP awards granted in 2014 – Performance criteria

In line with previous practice, awards granted to executive directors in March 2014 will be subject to four equally weighted performance categories, each of which can vest up to 100% of base salary subject to an overall cap of 300% of salary. The performance targets have been reviewed by the Committee and reflect the outcome of the Group's strategic review. In future years, long-term incentive awards will be made under the RBS 2014 Employee Share Plan on the basis of equally stretching measures following consultation with major shareholders and disclosed in the annual report on remuneration. A minimum three year performance period will apply. Any awards that vest will be subject to a minimum six month retention period in line with the PRA Remuneration Code.

Economic profit (25%)

The Economic Profit measure will be based on the 'go-forward' RBS business to align with the long-term future and earnings for the business. Economic Profit, being a risk-adjusted financial measure, is consistent with the PRA Code and also provides a balance between measuring growth and the cost of capital employed in delivering that growth. Economic Profit is defined as Operating Profit after Tax and preference share charges less attributed equity multiplied by the cost of equity, where

- Operating Profit after Tax is Operating Profit taxed at a standard tax rate.
- Attributed Equity is defined as equity allocated to the businesses, calculated as a function of the businesses risk-weighted asset base.
- Current Cost of Equity is 11.0%, which is subject to review at least annually.

Details of the actual targets, and performance against these, will be disclosed retrospectively once the awards vest.

Relative Total Shareholder Return (25%)

The relative TSR measure provides a direct connection between executive directors' awards and relative performance delivered to shareholders. The measure compares performance against a group of comparator banks. The comparator group has been changed for the 2014 awards to be more in line with the new strategic direction of RBS. This has involved removing from the comparator group non-European firms, which in particular reduces the exposure of the peer group to US and Markets activity.

Relative TSR Comparator Group

		Weighting
1	Barclays	200%
2	Lloyds Banking Group	
3	HSBC	100%
4	Standard Chartered	
5 to 13	BBVA, BNP Paribas, Credit Agricole, Credit Suisse Group, Deutsche Bank, Santander, Societe Generale, UBS, Unicredito	50%

· 20% of the award will vest if TSR is at the median of the companies in the comparator group

· 100% of the award will vest if TSR is at the upper quartile of the companies in the comparator group

Safe & Secure Bank (25%)

The Safe & Secure Bank measures have a particular focus on risk reduction and the building of a safer, sustainable franchise. The key measures in this category are Core Tier 1 ratio and Cost Income ratio.

Customers & People (25%)

These measures reward management for building a customer-focussed franchise with strength in terms of efficiency, reputation, and the engagement of employees. Net Promoter Score will be used as the primary bank-wide measure for the improvement in customer service, measured versus each segment's defined peer group. Employee engagement will be measured against the Global Financial Services norm.

Performance measures and weightings

Safe & Secure Bank measures (25%)	Core Tier 1 ratio (12.5%) Cost:Income ratio (12.5%)
Customers & People measures (25%)	Net Promoter Score (12.5%) Employee Engagement Index (12.5%)

Commentary will be provided on an annual basis in relation to progress against the targets, where these are not commercially sensitive.

Target ranges will be set for each measure, and will determine vesting, although the overall vesting under the Safe & Secure Bank and Customers & People categories will be qualified by Group Performance and Remuneration Committee discretion taking into account changes in circumstances over the performance period, the margin by which individual targets have been missed or exceeded, and any other relevant factors.

Risk underpin and clawback

The Committee will also review financial and operational performance against the business strategy and risk performance prior to agreeing vesting of awards. In assessing this, the Committee will be advised independently by the Board Risk Committee. If the Committee considers that the vesting outcome calibrated in line with the performance conditions outlined above does not reflect underlying financial results or if the Committee is not satisfied that conduct and risk management during the performance period has been effective then the terms of the awards allow for an underpin to be used to reduce vesting of an award, or to allow the award to lapse in its entirety. All awards are subject to clawback.

Annual report on remuneration

Consideration of matters relating to directors' remuneration

The role and responsibilities of the Committee

The Committee is responsible for setting the policy on remuneration and overseeing its implementation. It reviews performance and makes recommendations to the Board in respect of variable incentive pools and the remuneration arrangements of the executive directors. No director is involved in decisions regarding his or her own remuneration.

The Committee is also responsible for approving remuneration and severance arrangements for members of the Group's Executive and Management Committees and overseeing arrangements for PRA 'Code Staff'. Details of the PRA Remuneration Code can be found at www.bankofengland.co.uk/pra. A definition of RBS Code Staff along with details of how risk is taken into account in the remuneration process is provided on pages 91 and 92.

The terms of reference of the Group Performance and Remuneration Committee are available on www.rbs.com and these are reviewed at least annually by the Committee and approved by the Board.

Summary of the principal activity of the Committee during 2013

The Committee considered issues under the accountability review process at every meeting held in 2013 and CRD IV implementation at the majority of meetings held in 2013. Set out below is a summary of other key activities considered by the Committee.

First quarter

- 2012 performance reviews and arrangements for members of the Group's Executive and Management Committees, APS in scope employees, Code Staff and high earners. 2013 objectives for the Group's Executive and Management Committee members.
- Approval of Group and Divisional variable pay pools and Directors' Remuneration Report.
- Outcomes of the annual performance evaluation of the Committee.
- Assessment of the performance to date of unvested LTIP awards and performance targets for 2013 awards.
- Consideration of long-term incentive and deferral structure.

Second quarter

- Group Chief Executive departure terms and consideration of appointment and remuneration terms for various senior positions.
- Presentations from Markets, Corporate and Ulster Bank on business and strategic priorities and people plans.
- Review of the implementation of the remuneration policy.
- Review of the Committee's agenda planner, Terms of Reference and delegated authorities for individual remuneration governance.
- Terms of Reference for Group Sales and Service Incentives Committee – which considers short term incentive design principles.

Third quarter

- Half year performance reviews for members of the Group's Executive and Management Committees.
- Presentation from Retail on business and strategic priorities and people plans.
- Areas of focus for remuneration strategy.
- Purpose, Vision & Values and reward issues presentation.
- Consideration of the future shape of pay.

Fourth quarter

- 2013 preliminary variable pay pool discussions for Group and Divisions.
- Remuneration Policy Statement for the PRA.
- Update on Group Internal Audit's review of Code Staff processes.
- Share plan rules review update and AGM considerations.
- Update on shareholder consultation undertaken in December 2013 and planned for January 2014.

Performance evaluation process

A thorough internal review of the effectiveness of the Group Performance and Remuneration Committee was conducted during 2013 involving questionnaires and follow-up interviews. The Committee considered the outcomes of the evaluation and is satisfied with the way in which the evaluation has been conducted.

The review concluded that the Committee continued to operate effectively. Themes that emerged from the evaluation included recognition of the Committee workload and time spent outside of meetings, the ongoing importance of independence, management support and interaction with other Board Committees. Priorities that were identified for 2014 included recruiting an additional member of the Committee and considering how to streamline the agenda to maintain rigorous scrutiny and challenge on key issues. The outcomes of the evaluation have been reported to the Board.

Membership of the Group Performance and Remuneration Committee

All members of the Committee are independent non-executive directors. The Committee held nine scheduled meetings in 2013 and a further seven unscheduled meetings.

	Attended/ scheduled
Penny Hughes (Chair)	9/9
Sandy Crombie	9/9
Alison Davis	9/9
Art Ryan (1)	7/7

Note:
(1) Art Ryan stepped down from the Committee on 30 September 2013

Annual report on remuneration

Advisers to the Group Performance and Remuneration Committee

The advisers are appointed independently by the Committee, which reviews its selection of advisers annually. The Committee Chair oversees the fees for the advisers. PricewaterhouseCoopers LLP (PwC) were appointed as the Committee's remuneration advisers on 14 September 2010 following a review of potential advisers, and their appointment was reconfirmed by the Committee in July 2013 after an annual review of the quality of the advice received and fees charged. PwC are signatories to the voluntary code of conduct in relation to remuneration consulting in the UK.

PwC also provide professional services in the ordinary course of business including assurance, advisory, tax and legal advice to RBS subsidiaries. The Committee Chair is notified of other work that is being undertaken by PwC and is satisfied that there are processes in place to ensure that the advice the Committee receives is independent.
As well as receiving advice from PwC in 2013, the Committee took account at meetings of the views of the Chairman, Group Chief Executive, Group Finance Director, Human Resources Director, Head of Reward, the Group Secretary and the Chief Risk Officer. The fees paid to PwC for advising the Committee in relation to directors' remuneration are charged on a time/cost basis and in 2013 amounted to £190,465.

Statement of Shareholding Voting

The table below sets out the voting by shareholders on the advisory resolution to approve the Directors' 2012 Remuneration Report at the AGM held in May 2013.

For	Against	Total votes cast	Withheld
20,058,440,088 (99.32%)	138,246,040 (0.68%)	20,196,686,128	148,371,848

Shareholder dilution

During the ten year period to 31 December 2013, awards made that could require new issue shares under the company's share plans represented 4.2% of the company's issued ordinary share capital (including the B share capital), leaving an available dilution headroom of 5.8%. The company meets its employee share plan obligations through a combination of new issue shares and market purchase shares.

Penny Hughes
Chair of the Group Performance and Remuneration Committee
26 February 2014

Other Remuneration Disclosures

Remuneration of eight highest paid senior executives below Board (1)

All figures shown below are in GBP.

(£000s)	Executive 1	Executive 2	Executive 3	Executive 4	Executive 5	Executive 6	Executive 7	Executive 8
Fixed remuneration	639	1,352	700	199	463	415	189	350
Annual incentives	—	—	—	—	—	—	—	—
Long-term incentive awards (vested value)	983	978	407	—	—	56	—	114
Total remuneration (2)	1,622	2,330	1,107	199	463	471	189	464

Notes

(1) Remuneration earned for period worked in 2013 at RBS for members of Group Executive Committee plus Group HR Director.

(2) Disclosure includes prior year long-term incentive awards which vested during 2013. The amounts shown reflect the value of vested awards using the share price on the day the awards vested.

Other Remuneration Disclosures

Our Group-wide Remuneration Policy

The remuneration policy supports the business strategy and is designed to:

- Attract, retain, motivate and reward high-calibre employees to deliver long-term business performance within acceptable risk parameters; and
- Provide clear alignment between annual and long-term targets for individuals and strategic plans

The remuneration policy applies the same principles to all employees including Code Staff (1). The current key principles underpinning the remuneration policy for all employees are set out below.

Element of pay	Objective	Operation
Base salary	To attract and retain employees by being competitive in the specific market in which the individual works.	Base salaries are reviewed annually and should reflect the talents, skills and competencies that the individual brings to the business.
Role-based allowance	To provide fixed pay that reflects the skills and experience required for, and the responsibilities of, the role.	From 2014 onwards, allowances will be provided to certain employees in key roles and reviewed at appropriate intervals, to reflect the skills, experience and competencies required for the role. They will be delivered in cash and/or shares depending on the level of the allowance and the seniority of the recipient. Shares will be subject to an appropriate retention period, not less than six months.
Benefits (including pension)	To provide a range of benefits and give employees an opportunity to provide for their retirement.	In most jurisdictions, employee benefits or a cash equivalent are provided from a flexible benefits account.
Annual incentives	To support a culture where employees recognise the importance of serving customers well and are rewarded for superior performance.	The annual incentive pool is based on a balanced scorecard of measures including customer, financial, risk and people measures. Allocation from the pool depends on divisional, functional and individual performance. Individual performance assessment is supported by a structured performance management framework. Guaranteed awards are only used in very limited circumstances in accordance with the PRA Remuneration Code. Immediate cash awards are limited to a maximum of £2,000. Under the deferral arrangements a significant proportion of annual incentive awards for our more senior employees are deferred over a three year period. Deferred awards are subject to clawback. For Code Staff, a minimum 50% of any annual incentive is delivered in the form of RBS shares and subject to an additional six month retention period post vesting. Under the deferral arrangements for the 2013

		performance year, the vast majority of any annual incentive award to Code Staff is delivered in shares. In certain circumstances, formulaic short-term incentive arrangements are used to align the objectives of employees with the strategy of the relevant division in which they work.
Long-term incentive awards	To encourage the creation of value over the long term and to align further the rewards of the participants with the returns to shareholders.	RBS provides certain employees in senior roles with long-term incentive awards. Awards are structured as performance-vesting shares. Vesting may occur after a three year period and will typically be based partly on divisional or functional performance and partly on performance across the business. The amount of the award that vests may vary between 0-100% depending on the performance achieved. All awards are subject to clawback and an additional six month retention period applies to Code Staff post vesting.
Other share plans	To offer employees in certain jurisdictions the opportunity to acquire RBS shares.	Employees in certain countries are eligible to contribute to share plans which are not subject to performance conditions.

Note:
(1) The following groups of employees have been identified as meeting the PRA's criteria for Code Staff:
- Members of the Board and Executive and Management Committees
- Staff performing a Significant Influence Function within RBS
- Employees who have approval authorities such that their decision-making could have a material impact on the income statement
- Employees who are responsible for a business or businesses whose performance could have a material impact on the income statement; and
- Key control function roles

The RBS Staff Dealing Rules and the conditions attaching to discretionary share-based awards prohibit the use of any personal hedging strategies to lessen the impact of a reduction in value of such awards.

Other Remuneration Disclosures

How risk is reflected in our remuneration process

The RBS remuneration policy explicitly aligns remuneration with effective risk management. Focus on risk is achieved through clear risk input into objectives, performance reviews, the determination of variable pools and incentive plan design as well as the application of clawback. The Committee is supported in this by the Group Audit Committee, the Board Risk Committee and the Group's risk management function.

A robust process is used to assess risk performance. A range of measures are considered, specifically the overall Risk Profile, Credit, Regulatory Risk & Conduct Risk, Operational Risk, Enterprise Risk and Market Risk. The steps we take to ensure appropriate and thorough risk adjustment are also fully disclosed and discussed with the PRA and the FCA.

Variable pay pool determination

The process for determining variable pools is discretionary, to avoid the unintended consequences of formulaic systems. However, the Committee's discretion is applied within a structured framework which starts with an assessment of risk adjusted financial performance measured against budget, prior year capital position and long-term strategic plans. This analysis is used to adjust for performance and then consider outcomes in the context of competitive variable pay funding levels.

Risk is taken into account in the performance assessment through a thorough risk analysis carried out by the Group's risk management function to a pre-agreed framework. Performance assessments may be adjusted in situations where risk performance is outside risk appetite or strategic plans. Financial and non-financial performance factors (including risk) are taken into account in developing a final variable pay proposal. This decision also allows for considerations of market competitiveness and franchise protection.

Variable pay proposals are reviewed in the context of key compensation framework ratios including total compensation to revenue, total compensation to pre-compensation profit, variable pay to pre-variable pay profit and variable pool to pre-variable pool economic profit. These ratios help to ensure appropriate sharing of value between employees and shareholders and aim to provide transparency.

Finally, variable pay proposals are reviewed against our capital adequacy framework to ensure that regulatory requirements are met.

Accountability review process

Our Accountability Review process is an important tool in how we manage remuneration and manage adjustments to remuneration.

A summary of the accountability review process is as follows:

- Exists to enable RBS to respond in instances where current and/or new information would change the annual bonus and/or LTIP decisions made in previous years, and/or the decisions to be made in the current year.

- The process for review assessments (which consider material risk management, control and general policy breach failures, accountability for those events and appropriate action against individuals) is operated across divisions and functions.

- Divisional reviews are undertaken on a quarterly basis.

-

Decisions must take into account not only any financial losses, but also behavioural issues and reputational or internal costs.

- Clawback may be up to 100% of unvested awards and can be applied regardless of whether or not disciplinary action has been undertaken.

- A key principle is that clawback quantum should not be formulaic.

- Collective responsibility may be considered where a committee or group of employees are deemed to have not appropriately discharged their duties.

How have we applied this in practice?
Variable pay is subject to deferral allowing the Committee scope to apply clawback. The accountability review process is fully embedded and is operated throughout the year. During 2013 a number of issues and events were considered under the accountability review framework.

The outcomes for the 2013 performance year cover a range of actions and have included: forfeiture of unvested awards through clawback; reduction of current year variable pay awards; dismissal; and suspended vesting pending further investigation. The Board Risk Committee concluded that all known key material events had been considered.

The RBS 2014 Employee Share Plan, subject to approval at the 2014 AGM, will allow RBS to apply post-vesting clawback to future awards. The policy for any post-vesting clawback will be considered in light of emerging regulatory requirements and shareholder best practice.

Remuneration Code
As part of the annual remuneration governance process we provide details of our approach to pay and how we comply with the Remuneration Code to the PRA and FCA. As in previous years we have received the required regulatory confirmation in order to conclude our year end remuneration process.

Other Remuneration Disclosures

Code Staff Remuneration Disclosure

These disclosures are in accordance with the Prudential sourcebook for banks, building societies and investment firms (BIPRU) 11.5.18 (6) and (7).

1. Aggregate remuneration expenditure

During the year, there were 342 Code Staff. Aggregate remuneration expenditure was as follows:

Markets	Rest of RBS Group
£m	£m
78.5	135.0

2. Amounts and form of fixed and variable remuneration

Fixed remuneration

Consisted of salaries, pensions and benefits paid during the year.

Senior management	Others
£m	£m
56.9	42.9

Variable remuneration for 2013 performance

Consisted of deferred awards payable over a three year period. Cash awards were limited to a maximum of £2,000 per employee.

Form of remuneration	Senior management £m	Others £m
Variable remuneration (cash)	0.2	0.2
Deferred remuneration (bonds)	2.4	2.6
Deferred remuneration (shares)	31.1	51.7

Long-term incentives

Long-term incentive awards made each year are paid three years after the date of award based on the extent to which performance conditions are met and can result in zero payment.

Senior management	Others
£m	£m
18.5	6.9

3. Outstanding deferred remuneration through 2013

The table below includes deferred remuneration awarded or paid out in 2013. Deferred remuneration reduced during the year relates to long-term incentives lapsing when performance conditions are not met, long-term incentives and deferred awards forfeited on leaving and clawback of prior year deferred awards and long-term incentives.

Category of deferred remuneration	Senior management	Others

	£m	£m
Unvested from prior year	110.0	131.7
Awarded during the financial year	47.9	57.6
Paid out	33.0	59.4
Reduced from prior years	16.8	28.6
Unvested at year end	107.8	98.2

4. Sign-on and severance payments
Sign-on awards for guaranteed variable remuneration of £2.6 million are included in the tables above. These relate to commitments on recruitment made in respect of three new employees. No severance payments were made outside of contractual payments related to termination of employment such as pay in lieu of notice and benefits.

Notes on the presentation of remuneration
In the relevant tables above, assumptions have been made for the notional value of LTIP (verified by external advisors), forfeitures through resignation for deferred awards and the share price relevant to the date of the event or valuation point has been used.

All staff total remuneration
Total remuneration comprises; fixed pay, pension and benefit funding, variable remuneration and long-term incentives.

- The average salary for all employees is £34,000.
- 21,609 employees earn total remuneration between £50,000 and £100,000.
- 9,151 employees earn total remuneration between £100,000 and £250,000.
- 1,730 employees earn total remuneration over £250,000.

Total remuneration by band for all employees earning >£1 million	Number of employees
£1,000,000 - £1,500,000	46
£1,500,001 - £2,000,000	14
£2,000,001 - £2,500,000	4
£2,500,001 - £3,000,000	4
£3,000,001 - £3,500,000	—
£3,500,001 - £4,000,000	4
£4,000,001 - £4,500,000	1
£4,500,001 - £5,000,000	1
£5,000,001 - £5,500,000	—
£5,500,001 - £6,000,000	1

Notes:
(1) Total remuneration includes fixed pay, pension and benefit funding and variable pay (including actual value of LTIP vesting in respect of the performance period ending 2013) after the application of clawback.
(2) Excludes executive directors.

75 employees earn total remuneration of over £1 million which represent just 0.06% of our employees. This number reduces to 68 employees if we exclude pension and benefit funding.

These employees include those who manage major businesses and functions with responsibility for significant assets, earnings or areas of strategic activity and can be grouped as follows:

- The CEOs responsible for each division.
- Employees directly reporting to the CEO including those managing our functions and other activities of strategic importance.
- Employees managing large businesses within a division such as our Retail and Commercial Businesses in the US or our UK Corporate and Institutional Banking clients.
- Income generators responsible for high levels of income including those involved in managing trading activity and supporting clients with more complex financial transactions, including financial restructuring.
- Those responsible for managing our balance sheet and liquidity and funding positions across the business.
- Employees managing the successful disposal of Non-Core assets and reducing RBS's capital requirements.

Compliance report

Statement of compliance

The company is committed to high standards of corporate governance, business integrity and professionalism in all its activities.

Throughout the year ended 31 December 2013, the company has complied with all of the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council dated September 2012 (the "Code") except in relation to provision (D.2.2) that the Group Performance and Remuneration Committee should have delegated responsibility for setting remuneration for the Chairman and executive directors. The company considers that this is a matter which should rightly be reserved for the Board and this is an approach the company has adopted for a number of years. Remuneration for the Chairman and executive directors is first considered by the Group Performance and Remuneration Committee which then makes recommendations to the Board for consideration. This approach allows all non-executive directors, and not just those who are members of the Group Performance and Remuneration Committee, to participate in decisions on the executive directors' and the Chairman's remuneration and also allows the executive directors to input to the decision on the Chairman's remuneration. The Board believes this approach is very much in line with the spirit of the Code and no director is involved in decisions regarding his or her own remuneration. We do not anticipate any changes to our approach on this aspect of the Code. Information on how the company has applied the main principles of the Code can be found in the Corporate governance report on pages 38 to 93. A copy of the Code can be found at www.frc.org.uk

The company has also implemented the recommendations arising from the Walker Review. The company has also complied in all material respects with the Financial Reporting Council Guidance on Audit Committees issued in September 2012.

Under the US Sarbanes-Oxley Act of 2002, specific standards of corporate governance and business and financial disclosures apply to companies with securities registered in the US. The company complies with all applicable sections of the US Sarbanes-Oxley Act of 2002.

Internal control

Management of The Royal Bank of Scotland Group plc is responsible for implementing a system of internal control that is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In devising internal controls, management has regard to the nature and extent of the risk, the likelihood of it crystallising and the cost of controls. A system of internal control is designed to manage, but not eliminate, the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against the risk of material misstatement, fraud or losses.

Management's report on internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Group.

The Group's internal control over financial reporting is a component of an overall system of internal control and is designed to provide reasonable assurance regarding the preparation, reliability and fair presentation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS") and it includes:

- Policies and procedures that relate to the maintenance of records that, in reasonable detail, fairly and accurately reflect the transactions and disposition of assets.

- Controls providing reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with IFRS, and that receipts and expenditures are being made only as authorised by management.
- Controls providing reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use or disposition of assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with policies or procedures may deteriorate.

Management assessed the effectiveness of the Group's internal control over financial reporting as of 31 December 2013 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 1992 publication of "Internal Control – Integrated Framework".

Based on its assessment, management believes that, as of 31 December 2013, RBS Group's internal control over financial reporting is effective.

The effectiveness of RBS Group's internal control over financial reporting as of 31 December 2013 has been audited by Deloitte LLP, the Group's independent registered public accounting firm. The report of the independent registered public accounting firm to the directors of the Royal Bank of Scotland Group plc expresses an unqualified opinion on the effectiveness of the Group's internal control over financial reporting as of 31 December 2013.

Compliance report

Report of Independent Registered Public Accounting Firm to the members of The Royal Bank of Scotland Group plc
We have audited the internal control over financial reporting of The Royal Bank of Scotland Group plc and subsidiaries (‘’the Group”) as of 31 December 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Group’s management is responsible for maintaining effective internal control over financial reporting and for assessing its effectiveness as described in Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk of whether a material weakness existed, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Group maintained, in all material respects, effective internal control over financial reporting as of 31 December 2013, based on the criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended 31 December 2013 of the Group and our report dated 26 February 2014 (27 March 2014 as to the consolidating financial information included in Note 43 of the financial statements) expressed an unqualified opinion on those financial statements.

/s/ Deloitte LLP
London, United Kingdom
26 February 2014

Compliance report

Disclosure controls and procedures
Management, including our Chief Executive Officer and our Group Finance Director, conducted an evaluation of the effectiveness and design of our disclosure controls and procedures (as such term is defined in Exchange Act Rule 13a-15(e)). Based on this evaluation, our Chief Executive Officer and our Group Finance Director concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Changes in internal control
There was no change in the company's internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

The New York Stock Exchange
As a foreign issuer with American Depository Shares representing ordinary shares, preference shares and debt securities listed on the New York Stock Exchange (the "NYSE"), the company is not required to comply with all the NYSE standards applicable to US domestic companies (the "NYSE Standards") provided that it follows home country practice in lieu of the NYSE Standards and discloses any significant ways in which its corporate governance practices differ from the NYSE Standards. As a foreign private issuer, the company must, however, comply fully with the provisions of the NYSE Standards that relate to the composition, responsibilities and operation of audit committees. These provisions incorporate the relevant rules concerning audit committees of the Exchange Act.

The company has reviewed its corporate governance arrangements and is satisfied that these are consistent with the NYSE Standards, with the exception that the Chairman of the Board is also the Chairman of the Group Nominations Committee, which is permitted under the Code (since the Chairman was considered independent on appointment). In addition, although the members of the Group Performance and Remuneration Committee are deemed independent in compliance with the provisions of the Code, the Group Board has not assessed the independence of the members of the Group Performance and Remuneration Committee and of its compensation committee advisers in accordance with the independence tests prescribed by the NYSE standards. The company's Group Audit, Board Risk, Group Sustainability and Group Nominations Committees are otherwise composed solely of non-executive directors deemed by the Group Board to be independent. In addition, the NYSE Standards require that a compensation committee has direct responsibility to review and approve the Group Chief Executive's remuneration. As stated at the start of this Compliance report, in the case of the company, the Group Board, rather than the Group Performance and Remuneration Committee, reserves the authority to make the final determination of the remuneration of the Group Chief Executive.

The Group Audit Committee complies with the provisions of the NYSE Standards that relate to the composition, responsibilities and operation of audit committees. In April 2013, the company submitted its required annual written affirmation to the NYSE confirming its full compliance with those and other applicable provisions. More detailed information about the Group Audit Committee and its work during 2013 is set out in the Group Audit Committee report on pages 55 to 60.

This Compliance report forms part of the Corporate governance report and the Report of the directors.

Report of the directors

The directors present their report together with the audited accounts for the year ended 31 December 2013.

Group structure

The company is a holding company owning the entire issued ordinary share capital of The Royal Bank of Scotland plc, the principal direct operating subsidiary undertaking of the company. The Group comprises the company and all its subsidiary and associates, including the Royal Bank and NatWest.

Following placing and open offers in December 2008 and in April 2009, HM Treasury (HMT) owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HMT. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HMT's holding of ordinary shares of the company remained at 70.3%, although its economic interest rose to 84.4%.

At 31 December 2013, HMT's holding in the company's ordinary shares was 63.9% and its economic interest was 80.2%.

Results and dividends

The loss attributable to the ordinary and B shareholders of the company for the year ended 31 December 2013 amounted to £8,995 million compared with a loss of £6,055 million for the year ended 31 December 2012, as set out in the consolidated income statement on page 362.

The company did not pay a dividend on ordinary shares in 2012 or 2013.

On 26 November 2009, RBS entered into a State Aid Commitment Deed with HMT containing commitments and undertakings that were designed to ensure that HMT was able to comply with the commitments to be given by it to the European Commission for the purposes of obtaining approval for the State aid provided to RBS. As part of these commitments and undertakings, RBS agreed not to pay discretionary coupons and dividends on its existing hybrid capital instruments for a period of two years. This period commenced on 30 April 2010 for RBS Group instruments and ended on 30 April 2012; the two year deferral period for RBS Holdings N.V. instruments commenced on 1 April 2011 and ended on 1 April 2013.

The Group has now resumed payments on all discretionary non-equity capital instruments. Future coupons and dividends on hybrid capital instruments will only be paid subject to, and in accordance with, the terms of the relevant instruments.

In the context of prior macro-prudential policy discussions, the Board decided to partially neutralise any impact on Core Tier 1 capital of coupon and dividend payments in respect of 2013 Group hybrid capital instruments through equity issuances of c.£300 million. Consequently during the year, approximately £255 million was raised through the issue of new ordinary shares and a further £44 million was raised in connection with equity funding of employee incentive awards through the sale of surplus shares held by the Group's Employee Benefit Trust.

For 2014, the Board has decided to continue partially neutralising the Core Tier 1 impact of Group hybrid capital instruments. It is expected that £300 million of new equity will be issued during the course of 2014 to achieve this aim.

Business review

Activities
The Group is engaged principally in providing a wide range of banking and other financial services. Further details of the organisational structure and business overview of the Group, including the products and services provided by each of its divisions and the competitive markets in which they operate, are contained in the Business review on pages 106 to 108. Details of the strategy for delivering the company's objectives can be found in the Strategic report.

Risk factors
The Group's future performance and results could be materially different from expected results depending on the outcome of certain potential risks and uncertainties. Certain risk factors the Group faces are summarised in the Business review on pages 109 and 110. Fuller details of these and other risk factors are set out on pages 513 to 526.

The reported results of the Group are also sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. Details of the Group's critical accounting policies and key sources of accounting judgments are included in Accounting policies on pages 378 to 381.

The Group's approach to risk management, including its financial risk management objectives and policies and information on the Group's exposure to price, credit, liquidity and cash flow risk, is discussed in the Business review:risk and balance sheet management.

Financial performance
A review of the Group's performance during the year ended 31 December 2013, including details of each division, and the Group's financial position as at that date is contained in the Business review on pages 111 to 166.

RBS Holdings N.V. (formerly ABN AMRO Holding N.V.)
In 2007, RFS Holdings B.V., which was jointly owned by the Group, the Dutch State (successor to Fortis) and Santander (together, the "Consortium Members") completed the acquisition of ABN AMRO Holding N.V.

On 1 April 2010, the businesses acquired by the Dutch State were transferred to ABN AMRO Group N.V., itself owned by the Dutch State. In connection with the transfer ABN AMRO Holding N.V. was renamed RBS Holdings N.V. and its banking subsidiary was renamed The Royal Bank of Scotland N.V. ("RBS N.V.").

In October 2011, the Group completed the transfer of a substantial part of the UK activities of RBS N.V. to the Royal Bank. Substantially all of the Netherlands and EMEA businesses were transferred to the Royal Bank in September 2012. Russia, Korea and the North American businesses were transferred to the Royal Bank in 2013. Certain assets of RBS N.V. continue to be shared by the Consortium Members.

Report of the directors

Business divestments
To comply with the European Commission State Aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These include the divestment of Direct Line Insurance Group plc (DLG), the sale of 80.01% of the Group's Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK ("UK branch-based businesses").

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales and 6 NatWest branches in Scotland. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985.

The Group sold a first tranche of ordinary shares representing 34.7% of the ordinary issued share capital of Direct Line Group (DLG) in October 2012 through an initial public offering. On 13 March 2013, the Group sold a further 16.8% of the ordinary issued share capital in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013. On 20 September 2013, the Group sold a further 20% of the ordinary issued share capital in DLG.

On 26 February 2014 the Group announced that it had entered into a placing agreement to complete the sale of its remaining interest in DLG (except for 4.2 million shares held to satisfy long term incentive plan awards granted by the Group to DLG management). Accordingly, on settlement of the placing, the Group will have completed the disposal of DLG as required by the European Commission.

Strategic plan

Citizens Financial Group
In February 2013, the Group announced that it would commence work on a partial flotation of RBS Citizens Financial Group, Inc and in November 2013 confirmed that a partial initial public offering is now planned for 2014. The Group intends to fully divest the business by the end of 2016. The sale of RBS Citizens Financial Group, Inc is the cornerstone of the Group's new capital plan. The Group has appointed advisers and this is on schedule for later this year.

RBS Capital Resolution
In November 2013, the Group announced the creation of RBS Capital Resolution (RCR), to manage a pool of assets with particularly high long term capital intensity and/or potentially volatile outcomes in stressed environments. RCR became operational on 1 January 2014 with a portfolio of £29 billion assets. The RCR Board Oversight Committee has been established to provide oversight of RCR's progress against, and compliance with, its primary objective and asset management principles. It reports to the Board on its own activities and recommends changes, where appropriate, to RCR strategy.

Strategic review
In November 2013, the Group announced that it was undertaking a comprehensive business review of its customer-facing businesses, IT and operations and organisational and decision making structures. As described on pages 10 and 11, the Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved

resilience.

Employees

As at 31 December 2013, the Group employed 118,600 (full-time equivalent basis) throughout the world. Details of employee related costs are included in Note 3 on the consolidated accounts.

The Group operates certain employee share plans in which eligible employees are able to participate and which align the interests of employees with those of shareholders.

Employee learning and development

The 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. Supporting the professionalisation of our front line staff, just over 18,000 customer facing employees are now part of accreditation programmes aligned to the Chartered Banker professional standards. This helps our employees deliver the best service to our customers whilst working towards a recognised professional standard.

Employee communication

Employee engagement is encouraged through a range of communication channels, at both local 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 Group Chief Executive and other senior 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. In 2013, we renamed the survey Our View, reflecting the emphasis we place on a shared responsibility to build a better bank. The survey enables the business to monitor levels of employee satisfaction and engagement and how these compare with other companies. It also provides a further mechanism for RBS to track employee perception of the progress we are making in strengthening our culture. Insights from Our View inform what the business needs to do to improve the way it works, whether it’s a local issue or something that affects everyone.

Report of the directors

Employee consultation
The Group recognises employee representatives such as trade unions and work councils in a number of businesses and countries.

The Group has a European Employee Council that provides an opportunity for elected representatives and management to discuss developments in the Group's European operations.

Diversity and inclusion
During 2013, the Group executive continued its commitment to making workplace policies, processes and experiences inclusive for staff, customers and stakeholders.

Inclusion is built into various policy areas and people management processes. For example: the business continues to support disabled persons, ensuring there are equal opportunities in recruitment, employment, promotion and training.

The business also supports employee-led networks, with three being introduced this year relating to the areas of disability, multi-culturalism and carers. These new networks run alongside existing ones, 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 the Group aimed at cultivating future leaders, including ‘An Inspirational Journey’ and FTSE-100 cross-company mentoring programmes. The Group continues to maintain its involvement with external charitable networks and events such as Manchester Pride.

This approach to inclusion also extends to the marketplace with the RBS Women in Business specialists supporting and guiding more and more women to take the step of starting their own business.

Performance on gender diversity is monitored and reviewed at Group and local level and RBS remains supportive of the recommendations of Lord Davies’ Report. There are currently three female directors on the Board out of a total of eleven, which exceeds Lord Davies’ aspirational target of 25 per cent female Board representation. Further information on male/female representation at various levels of employment in the Group is included in the Strategic report on page 37.

Further details on the Board diversity policy can be found at rbs.com>about us.

This year the business has been recognised for its work on Equality, Diversity and Inclusion by achieving platinum ranking from Opportunity Now (gender), one of only a few organisations to achieve this; achieving Silver for Race for Opportunity (race); and securing a position in the Working Families Top 10.

Wellbeing
Ensuring the wellbeing of employees is an important responsibility for the Group.

A wide range of health benefits and services is in place to help employees maintain good physical and psychological health, and support them if they do become unwell. We continue to enhance and promote these services, targeting those issues that we know affect our employee's ability to bring the best of themselves to work. In 2013, we made Lifematters, the Group's Employee Assistance Programme, even more accessible with the introduction of our Lifematters mobile App.

Code of conduct

The code of conduct was fundamentally revised in 2013. How we behave forms the character of our company and dictates how others see us. "Our Code" reflects our values and applies to everyone who works for RBS. It lets everyone know what to expect of each other, what to do when unsure of a decision, and where to go for advice when needed.

The code of conduct is available at rbs.com>sustainability>governance> reporting and engagement. It will also be provided to any person without charge, upon request, by contacting RBS Secretariat at the telephone number listed on page 561.

Sustainability

Sustainability at RBS means building our future on long term thinking that focuses on our customers and supporting the communities in which they live. Our core duty is to be safe and strong. This underpins everything that RBS does and enables people to run their daily lives and businesses. This, in turn, supports economic growth and brings wider benefits to society. The final strand to building a sustainable business centres on how we choose to operate and how we can go further to shape the world in a positive way.

Sustainability is therefore not just about the many responsibilities and obligations that the Group has in a legal sense, but is about broad issues that need to be addressed to ensure that the Group is a healthy and respected business operating on a sustainable basis.

The Group Sustainability Committee is responsible for overseeing and challenging how management is addressing sustainability and reputation issues relating to all stakeholder groups and reports to the Board. For more information on the Committee, see pages 67 and 68.

Greenhouse gas emissions

Disclosures relating to greenhouse gas emissions are included in the Strategic report on page 36.

Report of the directors

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance and its objectives and policies in managing the financial risks to which it is exposed and its capital are discussed in the Business review. The risk factors which could materially affect the Group's future results are set out on pages 513 to 526. The Group's regulatory capital resources and significant developments in 2013 and anticipated future developments are detailed on pages 187 to 203. The liquidity and funding section on pages 204 to 221 describes the Group's funding and liquidity profile, including changes in key metrics, the build up of liquidity reserves and the outlook for 2014.

Having reviewed the Group's forecasts, projections and other relevant evidence, the directors have a reasonable expectation that the Group and the company will continue in operational existence for the foreseeable future. Accordingly, the financial statements of the Group and of the company have been prepared on a going concern basis.

BBA disclosure code

The Group's 2013 financial statements have been prepared in compliance with the principles set out in the Code for Financial Reporting Disclosure published by the British Bankers' Association in 2010.The Code sets out five disclosure principles together with supporting guidance. The principles are that the Group and other major UK banks will provide high quality, meaningful and decision-useful disclosures; review and enhance their financial instrument disclosures for key areas of interest to market participants; assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; seek to enhance the comparability of financial statement disclosures across the UK banking sector; and clearly differentiate in their annual reports between information that is audited and information that is unaudited.

Corporate governance

The company is committed to high standards of corporate governance. Details are given in the Corporate governance report on pages 38 to 93. The Corporate governance report and compliance report (pages 94 to 96) form part of this Report of the directors.

Share capital

Details of the ordinary and preference share capital at 31 December 2013 and movements during the year are shown in Note 26 on the consolidated accounts.

During 2013, the company allotted and issued a total of 78.6 million new ordinary shares of £1 each for the purposes of ensuring 2013 coupon payments on discretionary hybrid capital securities were partly neutralised from a Core Tier 1 capital perspective. The shares were allotted to UBS AG at the subscription prices and determined by reference to the average market prices during the sale periods set out below.

Number of shares sold	Subscription price	Sale period	Gross proceeds	Share price on allotment
42,967,903	314.188p	3 May 2013 - 17 July 2013	£135 million	321.6p
20,473,967	341.898p	2 August 2013 - 12 September 2013	£70 million	360.4p
15,091,674	331.309p			336.8p

1 November 2013 - 9 December 2013	£50 million

In addition, the company issued 53.7 million ordinary shares of £1 each in connection with employee share schemes.

Additional information
Where not provided elsewhere in the Report of the directors, the following additional information is required to be disclosed by Part 6 of Schedule 7 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The rights and obligations attaching to the company's ordinary shares and preference shares are set out in the company's Articles of Association, copies of which can be obtained from Companies House in the UK or can be found at rbs.com>about us.

On a show of hands at a general meeting of the company every holder of ordinary shares and cumulative preference shares present in person or by proxy and entitled to vote shall have one vote. On a poll, every holder of ordinary shares or cumulative preference shares present in person or by proxy and entitled to vote shall have four votes for every share held. The notices of Annual General Meetings and General Meetings specify the deadlines for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be passed at the meeting.

The cumulative preference shares represent less than 0.015% of the total voting rights of the company, the remainder being represented by the ordinary shares.

There are no restrictions on the transfer of ordinary shares in the company other than certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws). Pursuant to the Listing Rules of the FCA, certain employees of the company require the approval of the company to deal in the company's shares.

Report of the directors

The rules governing the powers of directors, including in relation to issuing or buying back shares and their appointment are set out in the company's Articles of Association. It will be proposed at the 2014 Annual General Meeting that the directors be granted authorities to allot shares under the Companies Act 2006. The company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

A number of the company's share plans include restrictions on transfers of shares while shares are subject to the plans or the terms under which the shares were awarded.

The rights and obligations of holders of non-cumulative preference shares are set out in Note 26 on the consolidated accounts.

Except in relation to the Dividend Access Share, the company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. There are no persons holding securities carrying special rights with regard to control of the company.

Under the rules of certain employee share plans, eligible employees are entitled to acquire shares in the company, and shares are held in trust for participants by The Royal Bank and Ulster Bank Dublin Trust Company as Trustees. Voting rights are exercised by the Trustees on receipt of participants' instructions. If a participant does not submit an instruction to the Trustee no vote is registered.

The Royal Bank of Scotland plc 1992 Employee Share Trust, The Royal Bank of Scotland Group plc 2001 Employee Share Trust and The Royal Bank of Scotland Group plc 2007 US Employee Share Trust hold shares on behalf of the Group's employee share plans. The voting rights are exercisable by the Trustees, however, in accordance with investor protection guidelines, the Trustees abstain from voting. The Trustees would take independent advice before accepting any offer in respect of their shareholdings for the company in a takeover bid situation.

Awards granted under the company's employee share plans may be met through a combination of newly issued shares and shares acquired in the market by the company's employee benefit trusts.

A change of control of the company following a takeover bid may cause a number of agreements to which the company is party to take effect, alter or terminate. All of the company's employee share plans contain provisions relating to a change of control. Outstanding awards and options may vest and become exercisable on change of control, subject where appropriate to the satisfaction of any performance conditions at that time and pro-rating of awards. In the context of the company as a whole, these agreements are not considered to be significant.

Directors
The names and brief biographical details of the current directors are shown on pages 42 to 45.

Sandy Crombie, Alison Davis, Tony Di Iorio, Philip Hampton, Penny Hughes, Brendan Nelson, Baroness Noakes and Philip Scott all served throughout the year and to the date of signing of the financial statements.

Joe MacHale and Art Ryan stepped down from the Board on 14 May 2013 and 30 September 2013 respectively.

Stephen Hester and Bruce Van Saun stepped down from the Board on 30 September 2013.

Ross McEwan and Nathan Bostock were appointed to the Board on 1 October 2013. Nathan has since confirmed his resignation although his leaving date is still to be agreed.

Robert Gillespie was appointed to the Board on 2 December 2013.

All directors of the company are required to stand for election or re-election annually by shareholders at the Annual General Meeting.

Directors' interests

The interests of the directors in the shares of the company at 31 December 2013 are shown on page 82. None of the directors held an interest in the loan capital of the company or in the shares or loan capital of any of the subsidiary undertakings of the company, during the period from 1 January 2013 to 26 February 2014.

Directors' indemnities

In terms of section 236 of the Companies Act 2006 (the "Companies Act"), Qualifying Third Party Indemnity Provisions have been issued by the company to directors, members of the Group's Executive and Management Committees, PRA/FCA Approved Persons and certain directors and/or officers of the Group's subsidiaries.

In terms of section 236 of the Companies Act, Qualifying Pension Scheme Indemnity Provisions have been issued to all trustees of the Group's pension schemes.

Post balance sheet events

Other than those matters detailed in Note 42 on the consolidated accounts, there have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

Report of the directors

Shareholdings
The table below shows shareholders that have notified the Group that they hold more than 3% of the total voting rights of the company at 31 December 2013.

Solicitor For The Affairs of Her Majesty's Treasury as Nominee for Her Majesty's Treasury	Number of shares (millions)	% of share class held	% of total voting rights held
Ordinary shares	3,964	63.9	63.9
B shares (non-voting)	51,000	100	—

On 8 January 2014, the Group was notified that Her Majesty's Treasury's shareholding of ordinary shares as at 31 December 2013 represented 63.9% of the total voting rights. The decrease was as a result of a change in the total voting rights.

Political donations
At the Annual General Meeting in 2013, shareholders gave authority under Part 14 of the Companies Act, for a period of one year, for the company (and its subsidiaries) to make political donations and incur political expenditure up to a maximum aggregate sum of £100,000. This authorisation was taken as a precaution only, as the company has a longstanding policy of not making political donations or incurring political expenditure within the ordinary meaning of those words. During 2013, the Group made no political donations, nor incurred any political expenditure in the UK or EU and it is not proposed that the Group's longstanding policy of not making contributions to any political party be changed. Shareholders will be asked to renew this authorisation at the Annual General Meeting in 2014.

Directors' disclosure to auditors
Each of the directors at the date of approval of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act.

Auditors
The auditors, Deloitte LLP, have indicated their willingness to continue in office. A resolution to re-appoint Deloitte LLP as the company's auditors will be proposed at the forthcoming Annual General Meeting.

By order of the Board

Aileen Taylor
Secretary
26 February 2014

The Royal Bank of Scotland Group plc
is registered in Scotland No. SC45551

Statement of directors' responsibilities

This statement should be read in conjunction with the responsibilities of the auditor set out in their report on page 361.

The directors are responsible for the preparation of the Annual Report and Accounts. The directors are required by Article 4 of the IAS Regulation (European Commission Regulation No 1606/2002) to prepare Group accounts, and as permitted by the Companies Act 2006 have elected to prepare company accounts, for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union. They are responsible for preparing accounts that present fairly the financial position, financial performance and cash flows of the Group and the company. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the Annual Report and Accounts complies with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that to the best of their knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the Strategic Report and Directors' report (incorporating the Business review) include a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

In addition, the directors are of the opinion that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

By order of the Board

Philip Hampton	Ross McEwan	Nathan Bostock
Chairman	Group Chief Executive	Group Finance Director

26 February 2014

Board of directors

Chairman	Executive directors	Non-executive directors
Philip Hampton	Ross McEwan	Sandy Crombie
	Nathan Bostock	Alison Davis

Tony Di Iorio
Robert Gillespie
Penny Hughes
Brendan Nelson
Baroness Noakes
Philip Scott

Business review

Revisions

Direct Line Group

The Group sold the first tranche of ordinary shares representing 34.7% of the share capital of DLG in October 2012 via an Initial Public Offering. On 13 March 2013, the Group sold a further 16.8% of ordinary shares in DLG and ceded control. This fulfilled the Group's plan to cede control of DLG by the end of 2013. On 20 September 2013, the Group sold a further 20% of ordinary shares in DLG which is a step toward complete disposal by the end of 2014, as required by the European Commission. At 31 December 2013, the Group held 28.5% of the share capital in DLG.

In accordance with IFRS 5, DLG was classified as a discontinued operation in 2012. From 13 March 2013, DLG was classified as an associate and at 31 December 2013, the Group's interest in DLG was transferred to disposal groups.

Revised allocation of Business Services costs

In 2013, the Group reclassified certain costs between direct and indirect expenses for all divisions. Comparatives have been restated accordingly; the revision did not affect total expenses or operating profit.

Implementation of IAS 19 'Employee Benefits' (revised)

The Group implemented IAS 19 with effect from 1 January 2013. IAS 19 requires: the immediate recognition of all actuarial gains and losses; interest cost to be calculated on the net pension liability or asset at the long-term bond rate, such that an expected rate of return will no longer be applied to assets; and all past service costs to be recognised immediately when a scheme is curtailed or amended. Implementation of IAS 19 resulted in an increase in the loss after tax of £84 million for the year ended 31 December 2012 and £154 million for the year ended 31 December 2011. This also resulted in an increase in the loss per ordinary and B share of 0.8p for the year ended 31 December 2012 and 1.4p for the year ended 31 December 2011. Prior periods have been restated accordingly.

Implementation of IFRS 10 'Consolidated Financial Statements'

The Group implemented IFRS 10 with effect from 1 January 2013. IFRS 10 adopts a single definition of control: a reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity so as to vary returns for the reporting entity. IFRS 10 requires retrospective application. Following implementation of IFRS 10, certain entities that have trust preferred securities in issue are no longer consolidated by the Group. As a result there has been a reduction in non-controlling interests of £0.5 billion with a corresponding increase in Owners' equity (Paid-in equity); prior periods have been restated accordingly.

Glossary

A glossary of terms is provided on pages 549 to 556.

Business review

Description of business

Introduction

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

Following the placing and open offers in December 2008 and in April 2009, HM Treasury owned approximately 70.3% of the enlarged ordinary share capital of the company. In December 2009, the company issued a further £25.5 billion of new capital to HM Treasury. This new capital took the form of B shares, which do not generally carry voting rights at general meetings of ordinary shareholders but are convertible into ordinary shares and qualify as Core Tier 1 capital. Following the issuance of the B shares, HM Treasury's holding of ordinary shares of the company remained at 70.3% although its economic interest rose to 84.4%.

At 31 December 2013, HM Treasury’s holding in the company’s ordinary shares was 63.9% and its economic interest was 80.2%.

The Group had total assets of £1,028 billion and owners' equity of £59 billion at 31 December 2013. The Group's risk asset ratios at 31 December 2013 were a Total capital ratio of 16.5%, a Core Tier 1 capital ratio of 10.9% and a Tier 1 capital ratio of 13.1%.

Organisational structure

The Group’s activities during 2013 were organised on a divisional basis as follows:

UK Retail offers a comprehensive range of banking products and related financial services to the personal market. It serves customers through a number of channels including: the RBS and NatWest network of branches and ATMs in the United Kingdom, telephony, online and mobile. UK Retail is committed to serving customers well, making banking easier and convenient whilst ensuring that we do business in an open, honest and sustainable manner.

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

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

International Banking serves the world’s largest companies with a leading client proposition focused on financing, risk management and transaction services. It serves as the delivery channel for Markets products to international corporate clients. The division also serves international subsidiaries of clients from other RBS Group divisions (e.g. UK Corporate, Ulster Bank and US Retail & Commercial) through its international network.

Ulster Bank is a leading retail and commercial bank in Northern Ireland and the Republic of Ireland. It provides a comprehensive range of financial services through both its Retail Banking division, which provides loan and deposit products through a network of branches and direct channels, and its Corporate Banking division, which provides services to businesses and corporate customers.

US Retail & Commercial provides financial services primarily through the Citizens and Charter One brands. US Retail & Commercial is engaged in retail and corporate banking activities through its branch network in 12 states in the United States and through non-branch offices in other states.

In February 2013, the Group announced that it would commence work on a partial flotation of RBS Citizens and in November 2013 confirmed that a partial initial public offering is now planned for 2014. The Group intends to fully divest the business by the end of 2016.

The divisions discussed above are collectively referred to as Retail & Commercial.

Markets is a leading origination, sales and trading business across debt finance, fixed income and currencies. The division offers a unified service to the Group's corporate and institutional clients. The Markets' origination, 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.

A new strategy for the Markets division was announced in June 2013 enabling RBS to concentrate on its core customers' needs where the Markets business is strongest. Markets is now focused on our core fixed income capabilities across rates, foreign exchange, asset backed products, credit and debit capital markets, while de-emphasising some more capital intensive structured product areas.

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

Non-Core Division managed separately assets that the Group intended to run off or dispose of. The division contained a range of businesses and asset portfolios primarily from the legacy GBM businesses, higher risk profile asset portfolios including excess risk concentrations, and other illiquid portfolios. It also included a number of other portfolios and businesses including regional markets businesses that the Group had concluded were no longer strategic.

Business review
Description of business continued
Business Services supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services. Business Services drives efficiencies and supports income growth across multiple brands and channels by using a single, scalable platform and common processes wherever possible. It also leverages the Group's purchasing power and is the Group's centre of excellence for managing large-scale and complex change. For reporting purposes, Business Services costs are allocated to the divisions above. It is not deemed a reportable segment.

Business divestments
To comply with the European Commission State Aid requirements the Group agreed a series of restructuring measures to be implemented over a four year period from December 2009. These include the divestment of Direct Line Insurance Group plc, the sale of 80.01% of the Group’s Global Merchant Services business (completed in 2010) and the sale of substantially all of the RBS Sempra Commodities joint venture business (largely completed in 2010), as well as the divestment of the RBS branch-based business in England and Wales and the NatWest branches in Scotland, along with the direct SME customers across the UK (“UK branch-based businesses”).

In October 2012, Santander UK plc withdrew from its agreed purchase of the UK branch-based businesses. In September 2013, the Group reached an agreement with an investor consortium led by Corsair Capital and Centerbridge Partners for an investment in these businesses ahead of a stock market flotation. This includes 308 RBS branches in England and Wales and 6 NatWest branches in Scotland. The new bank will be called Williams & Glyn, the brand RBS used for its branches in England and Wales before 1985.

In March 2013 and September 2013, the Group sold a further 16.8% and 20% respectively of the total issued share capital in Direct Line Insurance Group plc (DLG). This followed the sale in October 2012 via an initial public offering of 520.8 million ordinary shares representing 34.7% of the total issued share capital. At 31 December 2013, the Group held 28.5% of the issued ordinary share capital of DLG.

On 26 February 2014 RBS announced that it had entered into a placing agreement to complete the sale of its residual interest in DLG (except for 4.2 million shares held to satisfy long term incentive plan awards granted by RBS to DLG management). Accordingly, on settlement of the placing, the Group will have completed the disposal as required by the European Commission.

RBS Capital Resolution (RCR)
In response to a recommendation by the Parliamentary Commission on Banking Standards, RBS worked closely with HM Treasury (HMT) and its advisers on a ‘good bank/bad bank’ review and identified a pool of c.£38 billion of assets with particularly high long-term capital intensity, credit risk and/or potentially volatile outcomes in stressed environments.

The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified and consequently RBS decided to create an internal ‘bad bank’, RBS Capital Resolution (RCR), to manage these assets down so as to release capital. RCR brings assets under common management and increases focus on the run down.

RCR became fully operational on 1 January 2014 with a pool of c.£29 billion of assets, down from the forecast of c.£38 billion due to accelerated disposals and increased impairments. Whilst RCR is of a similar size to the Non-Core division, the assets have been selected on a different basis and no direct comparisons can be drawn.

Strategic review

In November 2013, the Group announced that it was undertaking a comprehensive business review of its:
Customer-facing business,
IT and operations and Organisational and decision making structures.

The aim of the review is to improve the bank's performance and effectiveness in serving its customers, shareholders and wider stakeholders.

The Group has announced the results of its Strategic review, resulting in it being realigned into three businesses: Personal & Business Banking, Commercial & Private Banking, and Corporate & institutional Banking. In addition, the Group will be rationalising and simplifying its systems, based on a target architecture with improved resilience.

Competition

The Group faces strong competition in all the markets it serves. Banks' balance sheets have strengthened whilst loan demand remains subdued as many customers continue to deleverage even as the UK economy begins to show signs of recovery. Competition for retail deposits has eased somewhat as institutions have made progress towards building strong and diverse funding platforms for their balance sheets.

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

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

In the personal banking segment, the Group competes with UK clearing banks and building societies, major retailers and life assurance companies. In the mortgage market, the Group competes with UK clearing banks and building societies. Increasingly, the ambitions of non-traditional players in the UK market are gaining credibility, with new entrants active and seeking to build their platforms by acquiring businesses made available through restructuring of incumbents. The Group distributes life assurance products to banking customers in competition with independent advisors and life assurance companies.

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

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

In Ireland, Ulster Bank competes in retail and commercial banking with the major Irish banks and building societies, and with other UK and international banks and building societies active in the market. The challenging conditions in the Irish economy persist and many of the domestic Irish banks have required State support and are engaged in significant restructuring actions.

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

Business review

Risk factors

Summary of our Principal Risks and Uncertainties

Set out below is a summary of certain risks which could adversely affect the Group; it should be read in conjunction with the Risk and Balance Sheet management section on pages 169 to 359. This summary should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. A fuller description of these and other risk factors is included on pages 513 to 526.

- The Group's ability to implement its new strategic plan and achieve its capital goals depends on the success of its efforts to refocus on its core strengths and the timely divestment of RBS Citizens. The Group has undertaken since 2009 an extensive restructuring, including the disposal of non-core assets as well as businesses as part of the State Aid restructuring plan approved by the EC. The Group recently created RBS CRG to manage the run down of problem assets with the goal of removing such assets from the balance sheet over the next three years. The Group has also taken steps to strengthen its capital position and established medium term targets which will require the timely divestment of RBS Citizens to achieve. The Group is also undertaking a new strategic direction which will result in a significant downsizing of the Group, including simplifying the Group by replacing the current divisional structure with three customer segments. The level of structural change required to implement the Group's strategic and capital goals together with other regulatory requirements such as ring fencing are likely to be disruptive and increase operational risks for the Group. There is no assurance that the Group will be able to successfully implement its new strategy on which its capital plan depends or achieve its goals within the time frames contemplated or at all.

- Despite the improved outlook for the global economy over the near to medium-term, actual or perceived difficult global economic conditions and increased competition, particularly in the UK, create challenging economic and market conditions and a difficult operating environment for the Group's businesses. Uncertainties surrounding the referendum on Scottish independence and the implications of an affirmative outcome for independence are also likely to affect the Group. These factors, together with additional uncertainty relating to the recovery of the Eurozone economy where the Group has significant exposure and the risk of a return of volatile financial markets, in part due to the monetary policies and measures carried out by central banks, have been and will continue to adversely affect the Group's businesses, earnings, financial condition and prospects.

- The Group is subject to substantial regulation and oversight, and any significant regulatory or legal developments such as that which has occurred over the past several years could have an adverse effect on how the Group conducts its business and on its results of operations and financial condition. Certain regulatory measures introduced in the UK and in Europe relating to ring-fencing of bank activities may affect the Group's borrowing costs, may impact product offerings and the viability of certain business models and require significant restructuring with the possible transfer of a large number of customers between legal entities.

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

- The Group is subject to a number of regulatory initiatives which may adversely affect its business, including the UK Government's adoption of the Financial Services (Banking Reform) Act 2013, the US Federal Reserve's new rules for applying US capital, liquidity and enhanced prudential standards to certain of the Group's US operations and ongoing reforms in the European Union with respect to capital requirements, stability and resolution of financial institutions, including CRD IV and other currently debated proposals such as the Resolution and Recovery Directive.

- The Group's ability to meet its obligations including its funding commitments depends on the Group's ability to access sources of liquidity and funding. The inability to access liquidity and funding due to market conditions or otherwise or to do so at a reasonable cost due to increased regulatory constraints, could adversely affect the Group's financial condition and results of operations. Furthermore, the Group's borrowing costs and its access to the debt capital markets and other sources of liquidity depend significantly on its and the UK Government's credit ratings which would be likely to be negatively impacted by political events, such as an affirmative outcome of the referendum for the independence of Scotland.

- The Group's business performance, financial condition and capital and liquidity ratios could be adversely affected if its capital is not managed effectively or as a result of changes to capital adequacy and liquidity requirements, including those arising out of Basel III implementation (globally or by European, UK or US authorities) as well as structural changes that may result from the implementation of ring-fencing under the Financial Services (Banking Reform) Act 2013 or proposed changes of the US Federal Reserve with respect to the Group's US operations. The Group's ability to reach its target capital ratios in the medium term will turn on a number of factors including a significant downsizing of the Group in part through the sale of RBS Citizens.

- The Group is, and may be, subject to litigation and regulatory and governmental investigations that may impact its business, reputation, results of operations and financial condition. Although the Group settled a number of legal proceedings and regulatory investigations during 2013, the Group is expected to continue to have a material exposure to legacy litigation and regulatory matter proceedings in the medium term. The Group also expects greater regulatory and governmental scrutiny for the foreseeable future particularly as it relates to compliance with new and existing laws and regulations such as anti-money laundering and anti-terrorism laws.

- Operational and reputational risks are inherent in the Group's businesses.

Business review
Risk factors continued

- The Group is highly dependent on its information technology systems and has been and will continue to be subject to cyber attacks which expose the Group to loss of customer data or other sensitive information, and combined with other failures of the Group's information technology systems, hinder its ability to service its clients which could result in long-term damage to the Group's business and brand.

- The Group or any of its UK bank subsidiaries may face the risk of full nationalisation or other resolution procedures, including recapitalisation of the Group or any of its UK bank subsidiaries, through bail-in which has been introduced by the Financial Services (Banking Reform) Act 2013 and will come into force on a date stipulated by HM Treasury. These various actions could be taken by or on behalf of the UK Government, including actions in relation to any securities issued, new or existing contractual arrangements and transfers of part or all of the Group's businesses.

- As a result of the UK Government's majority shareholding in the Group it may be able to exercise a significant degree of influence over the Group including on dividend policy, the election of directors or appointment of senior management or limiting the Group's operations. The offer or sale by the UK Government of all or a portion of its shareholding in the company could affect the market price of the equity shares and other securities and acquisitions of ordinary shares by the UK Government (including through conversions of other securities or further purchases of shares) may result in the delisting of the Group from the Official List.

- The actual or perceived failure or worsening credit of the Group's counterparties or borrowers, including sovereigns in the Eurozone, and depressed asset valuations resulting from poor market conditions have led the Group to realise and recognise significant impairment charges and write-downs which have adversely affected the Group and could continue to adversely affect the Group if, due to a deterioration in economic and financial market conditions or continuing weak economic growth, it were to recognise or realise further write-downs or impairment charges.

- 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.

- Recent developments in regulatory or tax legislation and any further significant developments could have an effect on how the Group conducts its business and on its results of operations and financial condition, and the recoverability of certain deferred tax assets recognised by the Group is subject to uncertainty.

- The Group is required to make planned contributions to its pension schemes and to compensation schemes in respect of certain financial institutions, either of which, independently or in conjunction with additional or increased contribution requirements may have an adverse impact on the Group's results of operations, cash flow and financial condition.

Business review

Key financials

	2013	2012*	2011*
for the year ended 31 December	£m	£m	£m
Total income	19,757	17,941	24,651
Profit before impairment losses	189	2	7,311
Impairment losses	(8,432)	(5,279)	(8,707)
Operating (loss)/profit	(8,243)	(5,277)	(1,396)
Loss attributable to ordinary and B shareholders	(8,995)	(6,055)	(2,151)
Cost:income ratio	99%	100%	70%
Basic loss per ordinary and equivalent B share from continuing operations (pence)	(81.3p)	(54.5p)	(22.7p)

*Restated – see page 105.

	2013	2012	2011
At 31 December	£m	£m	£m
Funded balance sheet (1)	739,839	870,392	977,249
Total assets	1,027,878	1,312,295	1,506,867
Loans and advances to customers	440,722	500,135	515,606
Deposits (2)	534,859	622,684	611,759
Owners' equity	58,742	68,678	75,367
Risk asset ratios - Core Tier 1	10.9%	10.3%	10.6%
- Tier 1	13.1%	12.4%	13.0%
- Total	16.5%	14.5%	13.8%

Notes:

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

(2) Comprises deposits by banks and customer accounts.

Summary consolidated income statement for the year ended 31 December 2013

	2013	2012*	2011*
	£m	£m	£m
Net interest income	10,981	11,402	12,303
Fees and commissions receivable	5,460	5,709	6,379
Fees and commissions payable	(942)	(834)	(962)
Other non-interest income	4,258	1,664	6,931
Non-interest income	8,776	6,539	12,348
Total income	19,757	17,941	24,651
Operating expenses	(19,568)	(17,939)	(17,340)
Profit before impairment losses	189	2	7,311
Impairment losses	(8,432)	(5,279)	(8,707)
Operating loss before tax	(8,243)	(5,277)	(1,396)
Tax charge	(382)	(441)	(1,075)
Loss from continuing operations	(8,625)	(5,718)	(2,471)
Profit/(loss) from discontinued operations, net of tax			
- Direct Line Group	127	(184)	301
- Other	21	12	47
Profit/(loss) from discontinued operations, net of tax	148	(172)	348
Loss for the year	(8,477)	(5,890)	(2,123)
Non-controlling interests	(120)	136	(28)
Other owners' dividends	(398)	(301)	—
Loss attributable to ordinary and B shareholders	(8,995)	(6,055)	(2,151)
Basic loss per ordinary and equivalent B share from continuing operations	(81.3p)	(54.5p)	(22.7p)

*Restated - see page 105.

Business review

Results summary continued

2013 compared with 2012
Operating loss
Operating loss before tax for the year was £8,243 million compared with £5,277 million in 2012.

Total income
Total income increased 10% to £19,757 million in 2013 primarily reflecting a lower accounting charge for own credit partially offset by lower income in Markets.

Net interest income
Net interest income decreased by 4% to £10,981 million largely reflecting lower interest-earning asset balances partially offset by re-pricing initiatives. Group net interest margin improved by 10 basis points driven by moves to reprice deposits in a number of divisions, partially offset by a roll-off in higher yielding securities.

Non-interest income
Non-interest income increased to £8,776 million from £6,539 million in 2012. This included a loss on own credit adjustments of £120 million (2012 - £4,649 million), net gain on redemption of own debt of £175 million (2012 - £454 million) and movements in the fair value of the Asset Protection Scheme resulting in a £44 million charge in 2012. On a managed basis non-interest income decreased by 21% to £8,450 million in 2013 principally driven by lower income from trading activities in Markets as the division managed down the scale of the balance sheet and reduced risk. This was partially offset by a £506 million improvement in Non-Core trading losses. Operating lease and rental income fell by £392 million, largely reflecting the disposal of RBS Aviation Capital in 2012.

Within other operating income, Non-Core recorded a loss of £331 million excluding rental income, primarily related to fair value adjustments associated with investment properties.

The continuing, albeit modest, strengthening of RBS's credit profile resulted in a £120 million accounting charge in relation to own credit adjustments versus £4,649 million in 2012.

Liability management exercises undertaken by the Group during 2013 resulted in a net gain of £175 million (2012 - £454 million).

The Asset Protection Scheme, which the Group exited from in 2012, was accounted for as a credit derivative and movements in the fair value of the contract were taken as non-operating items. The APS fair value charge was £44 million in 2012.

The gain on strategic disposals of £161 million primarily relates to the disposal of the Group's remaining interest in WorldPay. In 2012 the gain of £113 million primarily related to the disposal of RBS Aviation Capital.

Operating expenses
Operating expenses increased to £19,568 million from £17,939 million in 2012. This included PPI costs of £900 million (2012 - £1,110 million), IRHP redress and related costs of £550 million (2012 - £700 million), regulatory and legal actions of £2,394 million (2012 - £381 million), integration and restructuring costs of £656 million (2012 - £1,415 million), write-down of goodwill of £1,059 million (2012 - £18 million) and write-down of other intangible assets of £344 million (2012 - £106 million). On a managed basis, total operating expenses fell by 4% to £13,313 million, with staff costs down 7% as headcount fell by 4,300 to 114,900, principally in UK Retail, Markets and Non-Core. Markets operating expenses decreased by 11% to £2,610 million and Non-Core by 36% to £605 million,

driven by exiting staff and lower central support requirements on run-down.

To reflect current experience of Payment Protection Insurance complaints received, the Group increased its PPI provision by £900 million in 2013 compared with £1,110 million in 2012, bringing the cumulative charge taken to £3.1 billion, of which £2.2 billion had been utilised at 31 December 2013.

Following an industry-wide review in 2012 conducted in conjunction with the Financial Services Authority, a charge of £700 million was booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules. In 2013, a further charge of £550 million was booked reflecting both higher volumes and anticipated redress payments, recalibration of our methodology based on experience during 2013, and additional administration charges.

Charges relating to regulatory and legal actions totalled £2,394 million compared with £381 million in 2012. These charges primarily relate to various claims and conduct related matters affecting Group companies, primarily those related to mortgage-backed securities and securities related litigation, following recent litigation settlements and regulatory decisions.

Integration and restructuring costs were £656 million compared with £1,415 million in 2012 with most of the costs relating to the Retail transformation a reduction in the size of Markets and programme costs for the EC mandated disposal of certain UK branch-based businesses.

Write-down of goodwill was £1,059 million compared with £18 million in 2012 as the International Banking division was written off in 2013. Write-down of other intangible assets, including software, of £344 million related to Markets.

The UK bank levy is based on the total chargeable equity and liabilities as reported in the balance sheet at the end of a chargeable period. The cost of the levy to the Group for 2013 was £200 million compared with £175 million in 2012.

Business review

Impairment losses
Impairment losses increased by 60% to £8,432 million from £5,279 million in 2012 primarily due to increased charges resulting from the establishment of RCR. Excluding the impact of RCR (£4,490 million), impairment losses fell by 25% to £3,942 million with significant improvements in Non-Core, Ulster Bank and UK Retail partially offset by increases in International Banking, US Retail & Commercial and Markets. Loan impairments represented 2.0% of gross loans and advances to customers excluding reverse repos compared with 1.2% in 2012.

Risk elements in lending at 31 December 2013 represented 9.5% of loans and advances excluding reverse repos, compared with 9.1% a year earlier. Provision coverage was 64% compared with 52% at 31 December 2012.

Tax
The tax charge was £382 million in 2013 compared with £441 million in 2012. The tax charge for the year reflects losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), a reduction in the carrying value of the deferred tax asset in respect of UK losses and the effect of the reduction of 3% in the rate of UK corporation tax enacted in July 2013.

Loss per share
Basic loss per ordinary and equivalent B share from continuing operations was 81.3p per share compared with 54.5p per share in 2012.

2012 compared with 2011
Operating loss
Operating loss before tax for the year was £5,277 million compared with £1,396 million in 2011.

Total income
Total income decreased 27% to £17,941 million in 2012, principally reflecting own credit adjustments partially offset by movements in the fair value of the Asset Protection Scheme (APS) and higher net gains on the redemption of own debt.

Net interest income
Net interest income decreased by 7% to £11,402 million largely reflecting lower interest-earning asset balances. Group net interest margin (NIM) increased slightly, despite very low interest rates and strong deposit competition.

Non-interest income
Non-interest income decreased to £6,539 million from £12,348 million in 2011. This included movements in the fair value of the Asset Protection Scheme resulting in a £44 million charge (2011 - £906 million), net gain on redemption of own debt of £454 million (2011 - £255 million) and a loss on own credit adjustments of £4,649 million (2011 - £1,914 million gain). On a managed basis, non-interest income decreased by £443 million in 2012 principally driven by lower net fees and commissions and a fall in insurance net premium income. Net fees and commissions fell largely due to weaker consumer spending volumes in the UK together with legislation changes in the US.

The Asset Protection Scheme, which the Group exited from during the year, was accounted for as a credit derivative and movements in the fair value of the contract were taken as non-operating items. The APS fair value charge was £44 million in 2012 bringing the cumulative charge for the APS to £2.5 billion.

Liability management exercises undertaken by the Group during 2012 resulted in a net gain of £454 million (2011 - £255 million).

The continuing strengthening RBS's credit profile resulted in a £4,649 million accounting charge in relation to own credit adjustments versus a gain of £1,914 million in 2011. This reflected a tightening of more than 340 basis points in the Group's credit spreads over the year.

Operating expenses

Operating expenses increased to £17,939 million from £17,340 million in 2011. This included PPI costs of £1,110 million (2011 - £850 million), IRHP redress and related costs of £700 million, regulatory fines of £381 million, integration and restructuring costs of £1,415 million compared with £1,016 million in 2011, and write-down of goodwill and other intangible assets of £124 million, principally as a result of exits from selective countries and lower revenue projections by Markets. On a managed basis, total operating expenses fell by 7% to £13,854 million, with staff costs down 6% as headcount fell by 8,300 to 119,200. The decline in expenses was largely driven by Non-Core run-down and lower variable compensation (particularly in Markets), including variable compensation award reductions and clawbacks following the settlements reached with UK and US authorities in relation to attempts to manipulate LIBOR. The run-off of discontinued businesses in Markets and International Banking, following the restructuring announced in January 2012, and simplification of processes and headcount reduction in UK Retail also yielded cost benefits.

To reflect current experience of Payment Protection Insurance complaints received, the Group increased its PPI provision by £1,110 million in 2012 compared with £850 million in 2011, bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion (59%) in redress had been paid by 31 December 2012.

Following an industry-wide review conducted in conjunction with the Financial Services Authority, a charge of £700 million has been booked for redress in relation to certain interest-rate hedging products sold to small and medium-sized businesses classified as retail clients under FSA rules.

On 6 February 2013, RBS reached agreement with the Financial Services Authority, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The Group continues to co-operate with other bodies in this regard and expects it will incur some additional financial penalties.

Integration and restructuring costs of £1,415 million increased by £394 million versus £1,021 million in 2011, primarily driven by costs incurred in relation to the strategic restructuring of Markets and International Banking (M&IB) that took place during 2012.

Business review

Results summary continued

The UK bank levy is based on the total chargeable equity and liabilities as reported in the balance sheet at the end of a chargeable period. The cost of the levy to the Group for 2012 was £175 million compared with £300 million in 2011.

Impairment losses
Impairment losses were £5,279 million, compared with £8,707 million in 2011, with Core impairments falling by £464 million and Non-Core by £1,694 million, mostly in the Ulster Bank and commercial real estate portfolios. There was also the non-repeat of the sovereign debt impairment in 2011. On a managed basis, impairment losses fell to £5,279 million from £7,437 million in 2011

In 2011, the Group recorded an impairment loss of £1,099 million in respect of its AFS portfolio of Greek government debt. In 2012, 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.

Risk elements in lending represented 9.1% of gross loans and advances to customers excluding reverse repos at 31 December 2012 (2011 - 8.6%).

Provision coverage of risk elements in lending was 52% (2011 - 49%).

Tax
The tax charge was £441 million in 2012, compared with £1,075 million in 2011. The high tax charge in the year reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), the reduction in the carrying value of deferred tax assets in Ireland in view of continuing losses, the reduction in the carrying value of deferred tax assets in Australia following the strategic changes to the Markets and International Banking businesses announced in January 2012 and the effect of the two reductions of 1% in the rate of UK corporation tax enacted in March 2012 and July 2012 on the net deferred tax balance.

Loss per share
Basic loss per ordinary and equivalent B share from continuing operations was 54.5p per share compared with 22.7p per share in 2011.

Business review

Analysis of results
Net interest income

	2013	2012	2011
	£m	£m	£m
Interest receivable (1)	16,740	18,530	21,036
Interest payable	(5,759)	(7,128)	(8,733)
Net interest income	10,981	11,402	12,303
Yields, spreads and margins of the banking business	%	%	%
Gross yield on interest-earning assets of the banking business (2)	3.08	3.12	3.23
Cost of interest-bearing liabilities of the banking business	(1.42)	(1.54)	(1.68)
Interest spread of the banking business (3)	1.66	1.58	1.55
Benefit from interest-free funds	0.36	0.34	0.34
Net interest margin of the banking business (4)	2.02	1.92	1.89
Gross yield (2)			
- Group	3.08	3.12	3.23
- UK	3.54	3.49	3.57
- Overseas	2.33	2.56	2.77
Interest spread (3)			
- Group	1.66	1.58	1.55
- UK	1.99	1.83	1.82
- Overseas	1.25	1.56	1.22
Net interest margin (4)			
- Group	2.02	1.92	1.89
- UK	2.21	2.03	2.04
- Overseas	1.72	1.75	1.69
The Royal Bank of Scotland plc base rate (average)	0.50	0.50	0.50
London inter-bank three month offered rates (average)			
- Sterling	0.52	0.82	0.87
- Eurodollar	0.24	0.43	0.33
- Euro	0.27	0.53	1.36

*Restated - see page 105.

Notes:
(1) Interest receivable includes £798 million (2012 - £565 million; 2011 - £627 million) in respect of loan fees forming part of the effective interest rate of loans and receivables.
(2) Gross yield is the interest earned on average interest-earning assets of the banking book.
(3) Interest spread is the difference between the gross yield and the interest rate paid on average interest-bearing liabilities of the banking business.
(4) Net interest margin is net interest income of the banking business as a percentage of average interest-earning assets of the banking business.
(5) The analysis into UK and overseas has been compiled on the basis of location of office.
(6) Interest receivable and interest payable on trading assets and liabilities are included in income from trading activities.

(7) Interest income includes amounts (unwind of discount) recognised on impaired loans and receivables. The average balances of such loans are included in average loans and advances to banks and loans and advances to customers.

Average balance sheet and related interest continued

		2013			2012		
		Average balance £m	Interest £m	Rate %	Average balance £m	Interest £m	Rate %
Assets							
Loans and advances to banks	- UK	42,466	261	0.61	33,656	248	0.74
	- Overseas	32,240	169	0.52	40,342	245	0.61
Loans and advances to customers	- UK	256,692	11,060	4.31	277,631	11,326	4.08
	- Overseas	143,104	4,065	2.84	151,692	4,862	3.21
Debt securities	- UK	38,082	624	1.64	49,872	1,015	2.04
	- Overseas	30,792	561	1.82	40,077	834	2.08
Interest-earning assets	- UK	337,240	11,945	3.54	361,159	12,589	3.49
	- Overseas	206,136	4,795	2.33	232,111	5,941	2.56
Total interest-earning assets	- banking business (1)	543,376	16,740	3.08	593,270	18,530	3.12
	- trading business (6)	216,211			240,131		
Interest-earning assets		759,587			833,401		
Non-interest-earning assets		467,779			596,971		
Total assets		1,227,366			1,430,372		
Percentage of assets applicable to overseas operations		33.0%			37.8%		
Liabilities							
Deposits by banks	- UK	7,997	144	1.80	18,347	216	1.18
	- Overseas	15,654	262	1.67	20,129	384	1.91
Customer accounts: demand deposits	- UK	123,707	501	0.40	121,541	643	0.53
	- Overseas	35,733	169	0.47	35,087	210	0.60
Customer accounts: savings deposits	- UK	93,245	1,266	1.36	84,972	1,479	1.74
	- Overseas	28,864	101	0.35	26,989	133	0.49
Customer accounts: other time deposits	- UK	28,566	433	1.52	35,848	522	1.46
	- Overseas	20,092	361	1.80	23,776	504	2.12
Debt securities in issue	- UK	44,085	1,162	2.64	60,709	1,681	2.77
	- Overseas	5,239	145	2.77	22,294	342	1.53
Subordinated liabilities	- UK	17,387	649	3.73	15,629	435	2.78
	- Overseas	5,873	237	4.04	5,461	380	6.96
Internal funding of trading business	- UK	(24,041)	348	(1.45)	(21,140)	264	(1.25)
	- Overseas	4,477	(19)	(0.42)	11,992	(65)	(0.54)

Interest-bearing liabilities	- UK	290,946	4,503	1.55	315,906	5,240	1.66
	- Overseas	115,932	1,256	1.08	145,728	1,888	1.30
Total interest-bearing liabilities	- banking business	406,878	5,759	1.42	461,634	7,128	1.54
	- trading business (6)	223,264			248,647		
Interest-bearing liabilities		630,142			710,281		
Non-interest-bearing liabilities:							
Demand deposits	- UK	55,303			46,420		
	- Overseas	21,304			27,900		
Other liabilities		452,068			571,963		
Owners' equity		68,549			73,808		
Total liabilities and owners' equity		1,227,366			1,430,372		
Percentage of liabilities applicable to overseas operations		28.7%			33.9%		

For the notes to this table refer to page 116.

Business review

Average balance sheet and related interest continued

		2011		
		Average balance £m	Interest £m	Rate %
Assets				
Loans and advances to banks	- UK	29,852	277	0.93
	- Overseas	41,716	403	0.97
Loans and advances to customers	- UK	293,777	11,970	4.07
	- Overseas	171,938	5,857	3.41
Debt securities	- UK	55,074	1,258	2.28
	- Overseas	58,027	1,271	2.19
Interest-earning assets	- UK	378,703	13,505	3.57
	- Overseas	271,681	7,531	2.77
Total interest-earning assets	- banking business (1)	650,384	21,036	3.23
	- trading business (6)	278,975		
Interest-earning assets		929,359		
Non-interest-earning assets		605,796		
Total assets		1,535,155		
Percentage of assets applicable to overseas operations		40.2%		
Liabilities				
Deposits by banks	- UK	17,224	242	1.41
	- Overseas	47,371	740	1.56
Customer accounts: demand deposits	- UK	112,777	666	0.59
	- Overseas	43,177	483	1.12
Customer accounts: savings deposits	- UK	76,719	1,177	1.53
	- Overseas	25,257	130	0.51
Customer accounts: other time deposits	- UK	39,672	481	1.21
	- Overseas	33,971	594	1.75
Debt securities in issue	- UK	108,406	2,606	2.40
	- Overseas	42,769	765	1.79
Subordinated liabilities	- UK	16,874	470	2.79
	- Overseas	5,677	270	4.76
Internal funding of trading business	- UK	(40,242)	149	(0.37)
	- Overseas	(8,783)	(40)	0.46
Interest-bearing liabilities	- UK	331,430	5,791	1.75

	- Overseas	189,439	2,942	1.55
Total interest-bearing liabilities	- banking business	520,869	8,733	1.68
	- trading business (6)	307,564		
Interest-bearing liabilities		828,433		
Non-interest-bearing liabilities:				
Demand deposits	- UK	46,495		
	- Overseas	19,909		
Other liabilities		565,279		
Owners' equity		75,039		
Total liabilities and owners' equity		1,535,155		
Percentage of liabilities applicable to overseas operations		37.1%		

For the notes to this table refer to page 116.

Business review

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.

	2013 over 2012 Increase/(decrease) due to changes in:		
	Average volume £m	Average rate £m	Net change £m
Interest-earning assets			
Loans and advances to banks			
UK	60	(47)	13
Overseas	(44)	(32)	(76)
Loans and advances to customers			
UK	(883)	617	(266)
Overseas	(263)	(534)	(797)
Debt securities			
UK	(214)	(177)	(391)
Overseas	(177)	(96)	(273)
Total interest receivable of the banking business			
UK	(1,037)	393	(644)
Overseas	(484)	(662)	(1,146)
	(1,521)	(269)	(1,790)
Interest-bearing liabilities			
Deposits by banks			
UK	155	(83)	72
Overseas	78	44	122
Customer accounts: demand deposits			
UK	(12)	154	142
Overseas	(4)	45	41
Customer accounts: savings deposits			
UK	(133)	346	213
Overseas	(9)	41	32
Customer accounts: other time deposits			
UK	110	(21)	89
Overseas	72	71	143
Debt securities in issue			
UK	443	76	519
Overseas	364	(167)	197
Subordinated liabilities			
UK	(53)	(161)	(214)
Overseas	(27)	170	143
Internal funding of trading business			
UK	(39)	(45)	(84)
Overseas	(34)	(12)	(46)
Total interest payable of the banking business			

UK	471	266	737
Overseas	440	192	632
	911	458	1,369
Movement in net interest income			
UK	(566)	659	93
Overseas	(44)	(470)	(514)
	(610)	189	(421)

Business review

Analysis of change in net interest income - volume and rate analysis continued

	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			
UK	32	(61)	(29)
Overseas	(13)	(145)	(158)
Loans and advances to customers			
UK	(673)	29	(644)
Overseas	(664)	(331)	(995)
Debt securities			
UK	(115)	(128)	(243)
Overseas	(376)	(61)	(437)
Total interest receivable of the banking business			
UK	(756)	(160)	(916)
Overseas	(1,053)	(537)	(1,590)
	(1,809)	(697)	(2,506)
Interest-bearing liabilities			
Deposits by banks			
UK	(15)	41	26
Overseas	495	(139)	356
Customer accounts: demand deposits			
UK	(49)	72	23
Overseas	78	195	273
Customer accounts: savings deposits			
UK	(133)	(169)	(302)
Overseas	(8)	5	(3)
Customer accounts: other time deposits			
UK	50	(91)	(41)
Overseas	200	(110)	90
Debt securities in issue			
UK	1,279	(354)	925
Overseas	325	98	423
Subordinated liabilities			
UK	33	2	35
Overseas	11	(121)	(110)
Internal funding of trading business			
UK	99	(214)	(115)
Overseas	13	12	25
Total interest payable of the banking business			
UK	1,264	(713)	551
Overseas	1,114	(60)	1,054

	2,378	(773)	1,605
Movement in net interest income			
UK	508	(873)	(365)
Overseas	61	(597)	(536)
	569	(1,470)	(901)

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Business review

Non-interest income
The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

	2013	2012	2011
	£m	£m	£m
Fees and commissions receivable – statutory basis	5,460	5,709	6,379
Fees and commissions payable			
- managed basis	(942)	(833)	(962)
- RFS Holdings minority interest	—	(1)	—
Statutory basis	(942)	(834)	(962)
Income from trading activities			
- managed basis	2,651	3,533	3,313
- own credit adjustments	35	(1,813)	293
- Asset Protection Scheme	—	(44)	(906)
- RFS Holdings minority interest	(1)	(1)	1
Statutory basis	2,685	1,675	2,701
Gain on redemption of own debt – statutory basis	175	454	255
Other operating income			
- managed basis	1,281	2,259	2,381
- own credit adjustments	(155)	(2,836)	1,621
- integration and restructuring costs	—	—	(3)
- strategic disposals	161	113	(25)
- RFS Holdings minority interest	111	(1)	1
Statutory basis	1,398	(465)	3,975
Total non-interest income – managed basis	8,450	10,668	11,111
Total non-interest income – statutory basis	8,776	6,539	12,348

*Restated - see page 105.

2013 compared with 2012
Non-interest income increased by £2,237 million to £8,776 million primarily due to the lower accounting charge for improved own credit of £120 million compared with £4,649 million in 2012.

Net fees and commissions fell by 7% principally reflecting declines in Markets, UK Corporate, International Banking and Non-Core.

The continuing strengthening of RBS’s credit profile, albeit modest, resulted in a £120 million accounting charge in relation to own credit adjustment compared with £4,649 million in 2012.

Income from trading activities increased by £1,010 million to £2,685 million principally due the lower charge in relation to own credit adjustment and increase in Non-Core partially offset by a decline in Markets, where income from trading activities declined by £1,048 million as the division managed down the scale of the balance sheet and reduced risk.

The increase in other operating income predominantly reflected lower accounting charges for own credit adjustments partially offset by losses on disposal and value adjustments in Non-Core. In addition, the disposal of RBS Aviation Capital in June 2012 resulted in a £392 million reduction in operating lease income.

2012 compared with 2011
Non-interest income was down 47% at £6,539 million primarily due to the accounting charge for improved own credit of £4,649 million compared with a credit of £1,914 million in 2011, offset by a lower fair value charge of £44 million compared with £906 million in 2011 on the Asset Protection Scheme.

Net fees and commissions fell by 10% largely due to a decline in UK Retail fees, as a result of weaker consumer spending volumes, and in Markets, primarily due to the run-off in the cash equity business.

Markets trading income was sustained, despite the significant reduction in trading assets following its restructuring early in 2012.

The decrease in other operating income predominantly reflected own credit adjustments and the disposal of RBS Aviation Capital in June 2012, which resulted in lower rental income in Non-Core, partially offset by a lower fair value charge on the Asset Protection Scheme.

The continuing strengthening of RBS’s credit profile resulted in a £4,649 million accounting charge in relation to own credit adjustment versus a gain of £1,914 million in 2011. This reflected a tightening of more than 340 basis points in the Group’s cash market credit spreads over the year.

APS is accounted for as a derivative and the movements in fair value are recorded each quarter. The fair value charge was £44 million in 2012 versus £906 million in 2011.

Business review

Operating expenses
The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

	2013 £m	2012* £m	2011* £m
Staff costs			
- managed basis	6,882	7,377	8,072
- integration and restructuring costs	280	812	464
- bonus tax	—	—	27
- RFS Holdings minority interest	1	(1)	(1)
Statutory basis	7,163	8,188	8,562
Premises and equipment			
- managed basis	2,233	2,096	2,246
- integration and restructuring costs	115	136	177
Statutory basis	2,348	2,232	2,423
Other administrative expenses			
- managed basis	2,947	2,899	2,922
- Payment Protection Insurance costs	900	1,110	850
- Interest Rate Hedging Products redress and related costs	550	700	—
- regulatory and legal actions	2,394	381	—
- integration and restructuring costs	255	325	364
- bank levy	200	175	300
- RFS Holdings minority interest	(2)	3	—
Statutory basis	7,244	5,593	4,436
Administrative expenses	16,755	16,013	15,421
Depreciation and amortisation			
- managed basis	1,251	1,482	1,606
- amortisation of purchased intangible assets	153	178	222
- integration and restructuring costs	6	142	11
Statutory basis	1,410	1,802	1,839
Write-down of goodwill	1,059	18	80
Write-down of other intangible assets	344	106	—
Operating expenses	19,568	17,939	17,340
Staff costs as a percentage of total income	36%	46%	35%

*Restated - see page 105.

2013 compared with 2012
Operating expenses increased by £1,629 million, or 9% primarily due to higher charges resulting from regulatory and legal actions, and write-down of goodwill and other intangible assets, primarily in International Banking. These were partially offset by lower charges on Payment Protection Insurance claims, Interest Rate Hedging Products redress and

integration and restructuring costs.

Staff expenses were down by 13%. Excluding integration and restructuring costs of £280 million (2012 - £812 million), staff costs were down 7%, as staff numbers (FTEs) fell by 4,100 to 118,400, principally in UK Retail, Markets and Non-Core.

Charges of £2,394 million of regulatory and litigation provisions were recorded during the year primarily relating to mortgage-backed and other securities litigation in the US.

Write-down of goodwill and other intangible assets was £1,403 million and includes £1,059 million relating to the International Banking division following an impairment review.

Charges for PPI redress and related costs totalled £900 million, down £210 million from 2012. Of the cumulative provision of £3.1 billion, £2.2 billion had been utilised at 31 December 2013. The remaining provision of £900 million covers approximately twelve months of redress and administrative expenses.

Charges of £550 million were booked for Interest Rate Hedging Product redress and administration costs, down £150 million from 2012. The cumulative provision was £1.25 billion at 31 December 2013.

Business review

Operating expenses continued

2012 compared with 2011
Operating expenses increased by £599 million, or 3% primarily due to charges resulting from legacy conduct issues partially offset by Non-Core run-down and run-off of exited businesses in Markets and International Banking, following the restructuring announced in January 2012. Simplification of processes and headcount reduction in UK Retail also yielded cost benefits.

Staff expenses were cut by 4%. Excluding integration and restructuring costs of £812 million (2011 - £464 million), staff costs were down 9%, as headcount fell by 10,200 to 118,700.

To reflect current experience of Payment Protection Insurance complaints received, RBS increased its PPI provision by £1,110 million in 2012, bringing the cumulative charge taken to £2.2 billion, of which £1.3 billion in redress had been paid by 31 December 2012.

On 31 January 2013, the Financial Services Authority announced the findings of its industry-wide review of the sale of Interest Rate Hedging Products to some small and medium-sized businesses that were classified as retail clients under FSA rules. As a result, RBS provided £700 million in 2012 to meet the costs of redress.

On 6 February 2013, RBS reached agreement with the Financial Services Authority, the US Department of Justice and the Commodity Futures Trading Commission in relation to the setting of LIBOR and other trading rates, including financial penalties of £381 million. The Group continues to co-operate with other bodies in this regard and expects it will incur some additional financial penalties.

Integration costs

	2013	2012	2011
	£m	£m	£m
Staff costs	—	—	38
Premises and equipment	1	(2)	6
Other administrative expenses	1	2	51
Depreciation and amortisation	—	—	11
	2	—	106

Note:
(1) Integration costs in 2011 excluded a £2 million charge included within net interest income and a loss of £3 million within other operating income in respect of integration activities.

Integration costs of £106 million in 2011 primarily relate to RBS N.V. (formerly ABN AMRO) integration activity during the year, which is now largely complete.

Accruals in relation to integration costs are set out below.

	At 1 January 2013	Charge to income statement	Utilised during the year	At 31 December 2013
	£m	£m	£m	£m
Premises and equipment	9	1	(10)	—
Other administrative expenses	5	1	—	6

	14	2	(10)	6

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Business review

Restructuring costs

	2013	2012*	2011*
	£m	£m	£m
Staff costs	194	700	342
Premises and equipment	112	141	155
Other administrative expenses	177	261	268
Depreciation and amortisation	6	142	—
	489	1,244	765

*Restated - see page 105.

2013 compared with 2012
Restructuring costs were £489 million compared with £1,244 million in 2012. These costs primarily relate to the Retail transformation and the reduction in the size of Markets.

2012 compared with 2011
Restructuring costs were £1,244 million compared with £765 million in 2011. The increase was primarily driven by costs incurred in relation to the strategic restructuring of Markets and International Banking announced in January 2012.

Accruals in relation to restructuring costs are set out below.

	At 1 January 2013	Currency translation adjustments	Charge to income statement	Utilised during the year	At 31 December 2013
	£m	£m	£m	£m	£m
Staff costs - redundancy	434	4	137	(396)	179
Staff costs - other	111	1	57	(125)	44
Premises and equipment	289	—	112	(97)	304
Other administrative expenses	264	1	177	(228)	214
Depreciation and amortisation	—	—	6	(6)	—
	1,098	6	489	(852)	741

Divestment costs

	2013	2012*	2011*
	£m	£m	£m
Staff costs	86	111	84
Premises and equipment	2	(2)	11
Other administrative expenses	77	62	50
	165	171	145

*Restated - see page 105.

Divestment costs of £165 million in 2013 (2012 - £171 million; 2011 - £145 million) relate to preparation for the European Commission mandated divestments.

Accruals in relation to divestment costs are set out below.

	At 1 January 2013 £m	Charge to income statement £m	Utilised during the year £m	At 31 December 2013 £m
Staff costs - redundancy	87	34	(104)	17
Staff costs - other	46	52	(96)	2
Premises and equipment	—	2	(2)	—
Other administrative expenses	73	77	(137)	13
	206	165	(339)	32

Business review

Impairment losses
The following tables reconcile the managed basis results (a non-GAAP measure) to the statutory basis results.

	2013	2012	2011
	£m	£m	£m
New impairment losses	8,688	5,620	9,234
Less: recoveries of amounts previously written-off	(256)	(341)	(527)
Charge to income statement	8,432	5,279	8,707
Comprising:			
Loan impairment losses	8,412	5,315	7,241
Securities			
- managed basis	20	(36)	198
- sovereign debt impairment and related interest rate hedge adjustments	—	—	1,268
Statutory basis	20	(36)	1,466
Charge to income statement	8,432	5,279	8,707
Of which RCR related (1)	4,490	—	—

Note:
(1) Pertaining to the creation of RCR and related strategy.

RBS Capital Resolution ('RCR') was set up from 1 January 2014 and will manage a pool of £29 billion of assets with particularly high capital intensity or potentially volatile outcomes in stressed environments, aiming to accelerate the run-down of these exposures over a three year period to free up capital for the bank. This revised strategy to run down high risk loans faster resulted in an increased impairment charge relating to impaired or non-performing assets transferred to RCR, reflecting adverse changes in our estimates of future cash flows. Further details about RCR are set out on pages 158 to 161.

2013 compared with 2012
Group loan impairment losses rose by 58% to £8,412 million reflecting the increased provisions recognised in connection with the creation of RCR. Adjusting for this, impairment losses fell by £1,393 million (26%) to £3,922 million, driven by significant improvements in Non-Core, Ulster Bank and UK Retail, partially offset by increases in International Banking, US Retail & Commercial and Markets.

Additional loan impairments arising from the RCR accelerated asset recovery strategy totalled £4,490 million, of which £3,118 million related to Non-Core, £892 million to Ulster Bank, £410 million to UK Corporate, £52 million to International Banking and £18 million to Markets.

Excluding the impact of the creation of RCR, Core Ulster Bank loan impairments fell by £482 million (35%) to £882 million, mainly as a result of continued improvement in retail mortgage debt-flow and in recovery trends. UK Retail loan impairments fell by £210 million (40%), primarily from lower default levels.

Excluding the impact of the creation of RCR, Non-Core loan impairments fell by £792 million to £1,528 million, reflecting the continued reduction in the overall portfolio.

2012 compared with 2011
Total impairment losses declined by £3,428 million to £5,279 million which included the non-repeat of a sovereign debt impairment and related interest rate hedge adjustment of £1,268 million in 2011. Within the total impairment losses, loan impairment losses declined by £1,926 million to £5,315 million, primarily driven by a £1,518 million fall in Non-Core impairments, mostly in the Ulster Bank and commercial real estate portfolios.

Core loan impairments were down £408 million, or 12%, largely due to lower default rates in UK Retail and an improved credit environment for US Retail & Commercial, which helped drive impairment reductions of £259 million and £165 million respectively. Core Ulster Bank impairments stabilised, though still at a very high level (£1,364 million in 2012 versus £1,384 million in 2011).

Loan impairments as a percentage of gross loans and advances improved by 30 basis points, principally reflecting the improved credit profile in Non-Core and the better US credit environment.

Loan impairment provisions rose to £21.3 billion, increasing coverage of risk elements in lending to 52%, compared with 49% in 2011.

Business review

Tax

	2013	2012*	2011*
	£m	£m	£m
Tax charge	(382)	(441)	(1,075)
	%	%	%
UK corporation tax rate	23.25	24.50	26.50

*Restated – see page 105.

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

	2013	2012*	2011*
	£m	£m	£m
Expected tax credit	1,916	1,293	370
Sovereign debt impairment where no deferred tax asset recognised	—	—	(275)
Other losses in year where no deferred tax asset recognised	(879)	(511)	(530)
Foreign profits taxed at other rates	(196)	(383)	(417)
UK tax rate change impact	(313)	(149)	(112)
Unrecognised timing differences	(8)	59	(20)
Non-deductible goodwill impairment	(247)	—	—
Items not allowed for tax			
- losses on disposals and write-downs	(20)	(49)	(72)
- UK bank levy	(47)	(43)	(80)
- regulatory and legal actions	(144)	(93)	—
- employee share schemes	(11)	(9)	(113)
- other disallowable items	(202)	(246)	(285)
Non-taxable items			
- gain on sale of RBS Aviation Capital	—	26	—
- gain on sale of WorldPay (Global Merchant Services)	37	—	12
- other non-taxable items	171	104	242
Taxable foreign exchange movements	(25)	(1)	4
Losses brought forward and utilised	36	2	2
Reduction in carrying value of deferred tax asset in respect of losses in			
- UK	(701)	—	—
- Australia	—	(191)	—
- Ireland	—	(203)	—
Adjustments in respect of prior years	251	(47)	199
Actual tax charge	(382)	(441)	(1,075)

*Restated - see page 105.

2013 compared with 2012
The tax charge in the year ended 31 December 2013 reflects losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), a reduction in the carrying value of the deferred tax asset in respect of UK losses and the effect of the reduction of 3% in the rate of UK corporation tax enacted in July 2013.

2012 compared with 2011
The high tax charge in 2012 reflects profits in high tax regimes (principally US) and losses in low tax regimes (principally Ireland), losses in overseas subsidiaries for which a deferred tax asset has not been recognised (principally Ireland), the reduction in the carrying value of deferred tax assets in Ireland in view of continuing losses, the reduction in the carrying value of deferred tax assets in Australia following the strategic changes to the Markets and International Banking businesses announced in January 2012, and the effect of the two reductions of 1% in the rate of UK corporation tax enacted in March 2012 and July 2012 on the net deferred tax balance.

Business review

Divisional performance

Operating profit/(loss) by division	2013	2012*	2011*
	£m	£m	£m
UK Retail	1,943	1,891	2,021
UK Corporate	1,060	1,796	1,924
Wealth	221	243	242
International Banking	279	594	755
Ulster Bank	(1,457)	(1,040)	(984)
US Retail & Commercial	647	754	537
Retail & Commercial	2,693	4,238	4,495
Markets	620	1,509	899
Central items	(89)	84	(34)
Core	3,224	5,831	5,360
Non-Core	(5,527)	(2,879)	(4,219)
Operating (loss)/profit - managed basis	(2,303)	2,952	1,141
Reconciling items			
Own credit adjustments	(120)	(4,649)	1,914
Payment Protection Insurance costs	(900)	(1,110)	(850)
Interest Rate Hedging Products redress and related costs	(550)	(700)	—
Regulatory and legal actions	(2,394)	(381)	—
Sovereign debt impairment and related interest rate hedge adjustments	—	—	(1,268)
Integration and restructuring costs	(656)	(1,415)	(1,021)
Gain on redemption of own debt	175	454	255
Write-down of goodwill	(1,059)	(18)	—
Asset Protection Scheme	—	(44)	(906)
Amortisation of purchased intangible assets	(153)	(178)	(222)
Strategic disposals	161	113	(105)
Bonus tax	—	—	(27)
Bank levy	(200)	(175)	(300)
Write-down of other intangible assets	(344)	(106)	—
RFS Holdings minority interest	100	(20)	(7)
Operating loss before tax - statutory basis	(8,243)	(5,277)	(1,396)

*Restated - see page 105.

Business review

Divisional performance continued

Impairment losses/(recoveries) by division	2013	2012	2011
	£m	£m	£m
UK Retail	324	529	788
UK Corporate	1,188	838	793
Wealth	29	46	25
International Banking	229	111	168
Ulster Bank	1,774	1,364	1,384
US Retail & Commercial	156	91	326
Retail & Commercial	3,700	2,979	3,484
Markets	92	37	38
Central items	64	40	(2)
Core	3,856	3,056	3,520
Non-Core	4,576	2,223	3,917
Managed basis	8,432	5,279	7,437
Reconciling items			
Sovereign debt impairment and related interest rate hedge adjustments	—	—	1,268
RFS Holdings minority interest	—	—	2
Statutory basis	8,432	5,279	8,707
Of which RCR related (1)	4,490	—	—

Net interest margin by division	2013	2012	2011
	%	%	%
UK Retail	3.57	3.58	3.95
UK Corporate	3.07	3.06	3.06
Wealth	3.56	3.73	3.23
International Banking	1.59	1.64	1.73
Ulster Bank	1.91	1.88	1.87
US Retail & Commercial	2.95	2.97	3.03
Retail & Commercial	2.94	2.92	2.96
Non-Core	(0.19)	0.31	0.60
Group net interest margin	2.02	1.92	1.89

Risk-weighted assets by division	2013	2012	2011
	£bn	£bn	£bn
UK Retail	43.9	45.7	48.4
UK Corporate	86.1	86.3	79.3
Wealth	12.0	12.3	12.9
International Banking	49.0	51.9	43.2
Ulster Bank	30.7	36.1	36.3
US Retail & Commercial	56.1	56.5	59.3
Retail & Commercial	277.8	288.8	279.4
Markets	64.5	101.3	120.3

Other	10.1	5.8	12.0
Core	352.4	395.9	411.7
Non-Core	29.2	60.4	93.3
Group before benefit of Asset Protection Scheme	381.6	456.3	505.0
Benefit of Asset Protection Scheme	—	—	(69.1)
Group before RFS Holdings minority interest	381.6	456.3	435.9
RFS Holdings minority interest	3.9	3.3	3.1
Group	385.5	459.6	439.0

Note:
(1) Pertaining to the creation of RCR and related strategy.

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

	2013	2012	2011
UK Retail	23,700	26,000	27,700
UK Corporate	13,700	13,300	13,600
Wealth	4,800	5,100	5,500
International Banking	4,700	4,600	5,600
Ulster Bank	4,700	4,500	4,200
US Retail & Commercial	18,500	18,700	19,500
Retail & Commercial	70,100	72,200	76,100
Markets	10,300	11,300	14,000
Central items	7,400	6,800	6,200
Core	87,800	90,300	96,300
Non-Core	1,400	3,100	4,700
	89,200	93,400	101,000
Business Services	29,200	29,100	29,800
Integration and restructuring	200	500	1,100
Group	118,600	123,000	131,900

UK Retail

	2013	2012	2011
	£m	£m	£m
Net interest income	3,979	3,990	4,302
Net fees and commissions	919	884	1,066
Other non-interest income	39	95	140
Non-interest income	958	979	1,206
Total income	4,937	4,969	5,508
Direct expenses			
- staff	(707)	(811)	(853)
- other	(562)	(372)	(437)
Indirect expenses	(1,401)	(1,366)	(1,409)
	(2,670)	(2,549)	(2,699)
Profit before impairment losses	2,267	2,420	2,809
Impairment losses	(324)	(529)	(788)
Operating profit	1,943	1,891	2,021
Analysis of income by product			
Personal advances	923	916	1,089
Personal deposits	468	661	961
Mortgages	2,606	2,367	2,277
Cards	838	863	950
Other	102	162	231
Total income	4,937	4,969	5,508
Analysis of impairments by sector			
Mortgages	30	92	182
Personal	180	307	437
Cards	114	130	169
Total impairment losses	324	529	788
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	—	0.1%	0.2%
Personal	2.2%	3.5%	4.3%
Cards	2.0%	2.3%	3.0%
Total	0.3%	0.5%	0.7%
Performance ratios			
Return on equity (1)	26.3%	24.4%	24.5%
Net interest margin	3.57%	3.58%	3.95%
Cost:income ratio	54%	51%	49%

For the notes to this table refer to the following page.

UK Retail continued

	2013	2012	2011
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	99.3	99.1	95.0
- personal	8.1	8.8	10.1
- cards	5.8	5.7	5.7
	113.2	113.6	110.8
Loan impairment provisions	(2.1)	(2.6)	(2.7)
Net loans and advances to customers	111.1	111.0	108.1
Risk elements in lending	3.6	4.6	4.6
Provision coverage (2)	59%	58%	58%
Customer deposits			
- current accounts	32.6	28.9	26.8
- savings	82.3	78.7	75.1
Total customer deposits	114.9	107.6	101.9
Assets under management (excluding deposits)	5.8	6.0	5.5
Loan:deposit ratio (excluding repos)	97%	103%	106%
Risk-weighted assets (3)			
- credit risk (non-counterparty)	36.1	37.9	41.1
- operational risk	7.8	7.8	7.3
Total risk-weighted assets	43.9	45.7	48.4

Notes:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
(3) Divisional RWAs are based on a long-term conservative average secured mortgage probability of default methodology rather than the current lower point in time basis required for regulatory reporting.

In March 2013 UK Retail announced its strategy to become a simpler and more customer-focused business. Investment of £700 million over the next 3-5 years has been committed to build the best retail bank in the UK. Good progress has been made with £180 million of investment during 2013 through a number of initiatives directed at enhancing customer service and simplification of products and services. These have included:

- Improvements to Mobile and Digital Banking which continue to evolve in line with how customers prefer to conduct their business. One example of this is the enhancements in the mobile application allowing customers to pay their mobile phone contacts and obtain cash without using their debit card with the award winning ‘Get Cash’. Investment in digital products and services continued in 2013, with 50% of eligible customers now banking online or on mobile. We currently have 5.6 million online users and 2.9 million customers using our mobile app with over 100 million transactions made in 2013. Branch counter transactions were 31 million or 11% lower across the same period. In addition, UK Retail now has over 2.5 million active mobile users, using the service 28 times a month on average. Mobile net promoter scores continued to increase in 2013.

- During the year UK Retail invested in the introduction of a new integrated telephony system, increased training and the professional development of our staff. We spent more time on each call to support excellent customer service and to promote relevant offerings, including self service.

- During Q1 2013 mortgage advisors attended extensive training courses to help ensure customers receive the best possible outcome to meet their needs. The training affected balance growth during H1 2013; however, application volumes have rebounded quickly with the launch of competitively priced products and the 'NatYes' and 'RBYES' advertising campaigns leading to H2 2013 applications being 30% higher than H1 2013. RBS was the first bank to be ready to deliver the second phase of the UK Government's Help To Buy scheme, launched in early October 2013. Extended opening hours in branches helped to deliver more than 3,000 approvals assisting young people and families across Britain buy their home. Gross mortgage lending increased 3% year-on-year to £14.3 billion with Q4 2013 25% higher than Q4 2012.

Business review
UK Retail continued

- Significant focus on streamlining processes has benefited all distribution channels, with the capacity created allowing more time for staff coaching and resulting in advisors spending more time and having better conversations with customers.

- In addition, our product range has been simplified down from 56 to 46 with several products winning awards. A highlight of this UK Retail strategy is the success of the new instant saver product launched in Q4 2012, which at the end of 2013 had more than £10 billion in balances. Furthermore, nearly 800,000 customers have registered for Cashback Plus online since launch in Q3 2013 and are being rewarded for using their debit cards with selected retailers.

- A major branch refurbishment programme is under way with over one quarter completed. 350 branches now have a digital banking zone where customers can use in-branch technology to access online banking. Wi-Fi in-branch allows customers to access their account via their own devices.

During 2013 good progress has been made with FCA (Financial Conduct Authority) reportable complaints, which declined 22%. In addition, the provision relating to historic Payment Protection Insurance (PPI) mis-selling was increased by £860 million, bringing the total to £3.0 billion. The PPI expense is not included in the operating profit of UK Retail.

In 2014, UK Retail will aim to maintain a leading position in digital banking, launching new capability and customer proposition through mobile devices.

2013 compared with 2012
Operating profit increased by 3% to £1,943 million driven by a 39% decline in impairment losses. Net interest income was broadly stable, though investment advice income was adversely impacted following changes introduced by the Retail Distribution Review (RDR). Costs increased primarily because of a higher FSCS levy and other regulatory charges totalling £116 million in the year, conduct-related provisions of £63 million and additional technology investment of £45 million.

Mortgage balance growth was affected in H1 2013 by mortgage advisor training; however, balances recovered during H2 2013 assisted by early adoption of the second phase of the UK Government's Help To Buy scheme. Gross lending increased to £8.9 billion in H2 2013. Customer deposits increased by 7%, above the UK market average of 4% due to strong growth in both current accounts (13%) and instant access savings accounts (15%).

Net interest income was broadly flat.

- Mortgage new business margins reduced in line with market conditions; however, overall book margins improved.

- Deposit margins declined reflecting the impact of continued lower rates on current account hedges. Savings margins, however, have increased over 2013 with improved market pricing.

Non-interest income fell by 2% to £958 million due to subdued advice income post RDR.

Direct costs increased by 7% due to higher FSCS levy and other regulatory charges and conduct-related provisions of £63 million. This was partly offset by lower staff costs due to a reduction in headcount of 2,300. Indirect costs increased by 3%, largely due to investment in technology.

Impairments declined by 39% to £324 million due to lower customer defaults across all products reflecting continued improvement in asset quality.

Risk-weighted assets declined by 4% to £43.9 billion largely reflecting balance reductions across the unsecured portfolio and quality improvements.

2012 compared with 2011
Operating profit fell by 6% as a 10% decline in income was only partly offset by lower costs, down 6%, and improved impairment losses, down 33%.

Mortgage balances grew by £4.1 billion with the share of new business at 10%, ahead of our stock level of 8%. Growth as a result of FLS was starting to appear by the end of the year as mortgage applications moved through the pipeline to completion. Deposit growth of 6% was in line with the market and drove a 300 basis point improvement in the loan:deposit ratio to 103%.

Net interest income was down 7% due to weaker deposit margins and reduction in unsecured balances, partly offset by mortgage growth. Unsecured balances now represent 13% of total loans and advances to customers compared with 23% in 2008, following realignment of risk appetite and strong mortgage growth. Net interest margin declined as a result of lower rates on current account hedges and increased competition on savings rates in the early part of the year, partly offset by widening asset margins.

Non-interest income was 19% lower mainly due to:

- lower unauthorised overdraft fees as we continue to help customers manage their finances by providing mobile text alerts and further improving mobile banking functionality;

- weak consumer confidence lowering spending and associated fees on cards; and

- lower investment income as a result of weak customer demand and less advisor availability due to restructuring and retraining in preparation for regulatory changes in 2013.

Costs were down £150 million, 6%, driven by the ongoing simplification of processes across the business, lower headcount and lower FSCS levy.

Impairment losses were £259 million or 33% lower, reflecting the continued benefit of risk appetite tightening in prior years and also a smaller unsecured loan book. Impairments as a percentage of loans and advances were 50 basis points versus 70 basis points in 2011.

Risk-weighted assets continued to improve over the year as the portfolio mix adjusted, with increases in lower-risk secured mortgages, decreases in unsecured lending and further quality improvements across the book.

UK Corporate	2013	2012	2011
	£m	£m	£m
Net interest income	2,874	2,974	3,092
Net fees and commissions	1,310	1,365	1,375
Other non-interest income	283	384	396
Non-interest income	1,593	1,749	1,771
Total income	4,467	4,723	4,863
Direct expenses			
- staff	(912)	(940)	(934)
- other	(442)	(364)	(390)
Indirect expenses	(865)	(785)	(822)
	(2,219)	(2,089)	(2,146)
Profit before impairment losses	2,248	2,634	2,717
Impairment losses	(1,188)	(838)	(793)
Operating profit	1,060	1,796	1,924
Analysis of income by business			
Corporate and commercial lending	2,557	2,636	2,643
Asset and invoice finance	671	685	660
Corporate deposits	350	568	694
Other	889	834	866
Total income	4,467	4,723	4,863
Analysis of impairments by sector			
Financial institutions	10	15	20
Hotels and restaurants	53	52	59
Housebuilding and construction	39	143	103
Manufacturing	50	49	34
Private sector education, health, social work, recreational and community services	138	37	113
Property	439	252	170
Wholesale and retail trade, repairs	74	112	85
Asset and invoice finance	32	40	38
Shipping	341	82	22
Other	12	56	149
Total impairment losses	1,188	838	793
Of which RCR related (1)	410	—	—
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Financial institutions	0.2%	0.3%	0.3%
Hotels and restaurants	1.1%	0.9%	1.0%
Housebuilding and construction	1.3%	4.2%	2.6%
Manufacturing	1.2%	1.0%	0.7%
Private sector education, health, social work, recreational and community services	1.6%	0.4%	1.3%
Property	2.0%	1.0%	0.6%
Wholesale and retail trade, repairs	0.9%	1.3%	1.0%
Asset and invoice finance	0.3%	0.4%	0.4%

Shipping	5.2%	1.1%	0.3%
Other	—	0.2%	0.6%
Total	1.2%	0.8%	0.7%

Note:

(1) Pertaining to the creation of RCR and related strategy.

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UK Corporate continued

	2013	2012	2011
Performance ratios			
Return on equity (1)	7.9%	14.5%	15.2%
Net interest margin	3.07%	3.06%	3.06%
Cost:income ratio	50%	44%	44%
Capital and balance sheet	£bn	£bn	£bn
Loans and advances to customers (gross)			
- financial institutions	5.5	5.8	5.8
- hotels and restaurants	4.7	5.6	6.1
- housebuilding and construction	2.9	3.4	3.9
- manufacturing	4.2	4.7	4.7
- private sector education, health, social work, recreational and community services	8.5	8.7	8.7
- property	22.0	24.8	28.2
- wholesale and retail trade, repairs	8.2	8.5	8.7
- asset and invoice finance	11.7	11.2	10.4
- shipping	6.5	7.6	7.8
- other	28.3	26.7	26.4
	102.5	107.0	110.7
Loan impairment provisions	(2.8)	(2.4)	(2.1)
Net loans and advances to customers	99.7	104.6	108.6
Total third party assets	105.0	110.2	114.2
Risk elements in lending	6.2	5.5	5.0
Provision coverage (2)	46%	45%	40%
Customer deposits	124.7	127.1	126.3
Loan:deposit ratio (excluding repos)	80%	82%	86%
Risk-weighted assets			
- credit risk (non-counterparty)	77.7	77.7	71.2
- operational risk	8.4	8.6	8.1
Total risk-weighted assets	86.1	86.3	79.3

Notes:
(1) Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

2013 was a year in which UK Corporate underlined its commitment to support the UK economy and played an active role in the communities it operates in.

As part of this commitment the Bank appointed Sir Andrew Large to undertake a thorough and independent review of the lending standards and practices used by RBS and NatWest. UK Corporate will implement all of the Independent Lending Review's recommendations and is adopting a revised strategy and capabilities to enhance support to SMEs and the wider UK economic recovery while maintaining sound lending practices.

As part of the division's concerted effort to support its SME customers, UK Corporate has been proactively reviewing the business needs of SME customers to understand if they could benefit from the offer of additional facilities. In 2013, over 12,000 customers were identified for additional funding under UK Corporate's 'Statements of Appetite' initiative. The initiative resulted in approximately £6 billion of new funding being offered to customers.

The division has continued to support the government-backed Funding for Lending Scheme (FLS) and as at 31 December 2013 had allocated in excess of £4.7 billion of new FLS-related lending to almost 25,000 customers, £3.1 billion of which has been drawn since the scheme was launched. Mid-sized manufacturers are being offered targeted support, with interest rates reduced by more than 1% in some cases. SME customers benefited from both lower interest rates and the removal of arrangement fees.

Business review

UK Corporate continued

As well as delivering a range of lending initiatives, UK Corporate continued to develop new propositions for its customers. Following a successful pilot UK Corporate launched a leading business-to-business online community platform, Bizcrowd, to support independent needs matching. By the end of 2013 Bizcrowd had over 27,000 users and is now helping to bring businesses together across the UK.

During the course of 2013 UK Corporate's Business Banking Enterprise Programme helped over 40,000 entrepreneurs through over 1,000 events. Through its combination of nationwide start-up surgeries, mobile business schools and business academies, the programme offers support and advice to aspiring entrepreneurs, new start-up businesses and established SMEs looking to grow. Combined with UK Corporate's skills-based volunteering scheme, a programme offering all employees five days to volunteer with a charitable organisation, UK Corporate continued to deliver on its on-going commitment to communities.

2013 compared with 2012

The business delivered a return on equity of 11.0% excluding the impact of increased impairment losses related to the creation of RCR, primarily property and shipping exposures, which reduced return on equity by 3.1%.

Net interest income was 3% lower at £2,874 million, as increased income from re-pricing initiatives was offset by the lower rate environment impacting deposit returns, the non-repeat of 2012 deferred income recognition revisions (£58 million) and reduced lending volumes, as loan repayments coupled with run-off in property and shipping sectors outpaced new lending.

Non-interest income reduced 9% to £1,593 million, primarily from lower Markets revenue share income, a decline in operating lease income (offset by an associated reduction of operating lease depreciation in expenses), lower lending fees and higher derivative close-out costs associated with impaired assets.

Expenses, increased 6% to £2,219 million, primarily as a result of remediation provisions of £68 million, an increased share of branch network costs and an uplift in investment spend. This was offset by the reduction in operating lease depreciation, a decline in Markets revenue share related costs and lower staff incentive expenditure.

Whilst full year impairments include the additional impact of increased impairment losses related to the creation of RCR (£410 million), underlying impairments improved by £60 million, or 7%, to £778 million due to lower individual and collectively assessed provisions in the SME business, partially offset by higher individual cases in the mid-to-large corporate business.

Risk-weighted assets were broadly in line with 2012 at £86.1 billion as reduced asset volumes and movements into default offset increases resulting from the implementation of risk model changes.

2012 compared with 2011

With economic factors continuing to suppress business confidence, 2012 saw lower income and operating profit. Nonetheless, the business delivered a return on equity of 14.5%, slightly below the prior year and comfortably ahead of the cost of capital.

Operating profit decreased by 7%, with income down 3% and increased impairments, up 6%, partially offset by a 3% decrease in costs.

Net interest income was 4% lower, reflecting a 3% fall in lending volumes as loan repayments outstripped new lending, deposit margin compression due to strong competition and the continuation of low yields on current accounts. This was partially offset by improved asset margins and a 1% increase in deposit volumes.

Non-interest income was broadly in line with 2011, with stable income from transaction services, asset finance, Markets revenue share and other lending fees.

Total costs were down 3% due to tight control over direct discretionary expenditure combined with lower indirect costs as a result of operational savings, partially offset by increased investment expenditure.

Core lending balances were up £200 million, excluding the property, housebuilding and construction sectors. The loan:deposit ratio decreased by 400 basis points, principally reflecting deposit growth and portfolio de-risking, particularly in commercial real estate. The Group took part in a number of Government initiatives, seeking responsibly to stimulate additional credit demand in the face of continued customer deleveraging and low business confidence levels.

Impairments increased by 6% with lower specific provisions, mainly in the SME business, more than offset by reduced levels of latent provision releases across the division (£44 million in 2012 versus £226 million in 2011). Impairments as a percentage of loans and advances edged up modestly to 80 basis points.

Risk-weighted assets increased by 9% as regulatory changes to capital models during H2 2012 totalling £15 billion (primarily the implementation of the market-wide slotting approach on real estate and increases to default risk weights in other models) were partly offset by a fall in funded assets.

Not reflected in operating results was UK Corporate’s £350 million share of the provision for interest rate swap redress which relates to prior periods, mainly pre-2008.

Business review

Wealth

	2013	2012	2011
	£m	£m	£m
Net interest income	674	720	645
Net fees and commissions	355	366	375
Other non-interest income	64	84	84
Non-interest income	419	450	459
Total income	1,093	1,170	1,104
Direct expenses			
- staff	(405)	(419)	(405)
- other	(124)	(162)	(134)
Indirect expenses	(314)	(300)	(298)
	(843)	(881)	(837)
Profit before impairment losses	250	289	267
Impairment losses	(29)	(46)	(25)
Operating profit	221	243	242
Analysis of income			
Private banking	894	956	902
Investments	199	214	202
Total income	1,093	1,170	1,104
Performance ratios			
Return on equity (1)	12.0%	13.1%	12.8%
Net interest margin	3.56%	3.73%	3.23%
Cost:income ratio	77%	75%	76%
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	8.7	8.8	8.3
- personal	5.6	5.5	6.9
- other	2.5	2.8	1.7
	16.8	17.1	16.9
Loan impairment provisions	(0.1)	(0.1)	(0.1)
Net loans and advances to customers	16.7	17.0	16.8
Risk elements in lending	0.3	0.2	0.2
Provision coverage (2)	43%	44%	38%
Assets under management (excluding deposits)	29.7	28.9	30.9
Customer deposits	37.2	38.9	38.2
Loan:deposit ratio (excluding repos)	45%	44%	44%
Risk-weighted assets			
- credit risk (non-counterparty)	10.0	10.3	10.9
- market risk	0.1	0.1	0.1

- operational risk	1.9	1.9	1.9
Total risk-weighted assets	12.0	12.3	12.9

Notes:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

Wealth continued

2013 saw a major shake-up of the UK financial advice landscape with the implementation of the Retail Distribution Review (RDR). Clients welcomed Coutts' new fully compliant advice-led model where Coutts requires its advisers to achieve the more stringent Level 6 rating, in excess of the FCA's minimum Level 4 requirement. Coutts has received a number of industry accolades for its levels of service, such as 'UK Private Bank of the Year' (The Banker Global Private Banking Awards). Total assets under advice grew to approximately £3 billion over the year.

Following the deposit re-pricing strategy implemented in the second half of 2013 deposit margins have significantly improved. Lending volumes have remained resilient despite pay-downs in line with best-advice policy under RDR. In addition, a new international trust strategy was announced, strengthening the client offering by positioning it as a market-leading, client-centric trust business. This was achieved by the creation of a centre of excellence in Jersey, accompanied by withdrawal from the Cayman Islands and restructuring of the Geneva trust business.

Work continued on streamlining client-facing processes and driving increased benefits from the division's global technology platform, including significant enhancements to Coutts' online and digital client channels. A streamlining of the London property footprint from 11 buildings to 2 was also concluded, alongside further office rationalisation in the International business.

2013 compared with 2012

Operating profit was 9% lower at £221 million, driven by lower income partially offset by a decrease in expenses and impairment losses.

Income declined by 7% to £1,093 million, with the reduction in net interest income reflecting the lower spread earned on deposits as a result of lower Group funding requirements.

Non-interest income fell by 7% to £419 million due to the disposal of the Latin American, Caribbean and African businesses for a profit of £15 million in H1 2012 together with a decline in fee income in the International business.

Expenses were 4% lower at £843 million as a result of reduced headcount, tight discretionary cost management and the non-recurrence of two regulatory fines totalling £26 million incurred during 2012. This was partially offset by a one-off UK tax treaty charge in the International business.

Client assets and liabilities managed by the division declined by 2%, with a £1.7 billion reduction in deposits following re-pricing initiatives in the UK in line with the wider Group funding strategy. Assets under management increased by 3% due to positive market movements. Lending was 2% lower, reflecting increased levels of repayments in the UK.

Impairments were £17 million lower at £29 million, largely reflecting a small number of specific impairments.

2012 compared with 2011

Operating profit increased by £1 million to £243 million driven by higher income partially offset by increased expenses and impairment losses.

Total income increased by £66 million, with net interest income up £75 million, largely driven by improvements in margins and strong divisional treasury income, particularly during H1 2012.

Non-interest income fell by 2% as the gain from the disposal of the Latin American, Caribbean and African businesses was more than offset by a decline in fee income in the UK and lower investment volumes, driven by continued economic uncertainty.

Expenses were £44 million or 5% higher at £881 million, with significant investment in change programmes, including the development of new products and services capability and the implementation of RDR in the UK.

Expenses also increased as a result of client redress following a past business review into the sale of the ALICO Enhanced Variable Rate Fund announced in November 2011 and a Financial Services Authority fine of £8.75 million relating to Anti Money Laundering control processes.

Client assets and liabilities fell by 1% with a £2 billion decrease in assets under management, primarily reflecting low margin client outflows of £1.4 billion and the impact of client transfers following the disposal of the Latin American, Caribbean and African businesses. This fall was partially offset by increases in lending and deposit volumes.

Impairment losses were £46 million, up £21 million, largely reflecting a small number of large specific impairments.

Business review

International Banking	2013	2012	2011
	£m	£m	£m
Net interest income from banking activities	713	922	1,199
Funding costs of rental assets	—	(9)	(42)
Net interest income	713	913	1,157
Non-interest income	1,135	1,209	1,398
Total income	1,848	2,122	2,555
Direct expenses			
- staff	(530)	(580)	(710)
- other	(171)	(164)	(228)
Indirect expenses	(639)	(673)	(694)
	(1,340)	(1,417)	(1,632)
Profit before impairment losses	508	705	923
Impairment losses	(229)	(111)	(168)
Operating profit	279	594	755
Of which:			
Ongoing businesses	279	602	773
Run-off businesses	—	(8)	(18)
Analysis of income by product			
Cash management	738	943	940
Trade finance	295	291	275
Loan portfolio	814	865	1,265
Ongoing businesses	1,847	2,099	2,480
Run-off businesses	1	23	75
Total income	1,848	2,122	2,555
Analysis of impairments/(recoveries) by sector			
Manufacturing and infrastructure	147	42	254
Property and construction	15	7	17
Transport and storage	55	(3)	11
Telecommunications, media and technology	(7)	12	—
Banks and financial institutions	(15)	43	(42)
Other	34	10	(72)
Total impairment losses	229	111	168
Of which RCR related (1)	52	—	—
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements)	0.6%	0.3%	0.3%
Performance ratios (ongoing businesses)			
Return on equity (2)	3.9%	9.1%	11.5%
Net interest margin	1.59%	1.64%	1.73%
Cost:income ratio	73%	66%	62%

Notes:
(1) Pertaining to the creation of RCR and related strategy.
(2) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for the ongoing businesses.

Business review

International Banking continued

	2013	2012	2011
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross) (1)	36.0	42.2	57.7
Loan impairment provisions	(0.3)	(0.4)	(0.8)
Net loans and advances to customers	35.7	41.8	56.9
Loans and advances to banks	8.0	4.8	3.4
Securities	2.4	2.6	6.0
Cash and eligible bills	0.3	0.5	0.3
Other	2.1	3.3	3.3
Total third party assets (excluding derivatives mark-to-market)	48.5	53.0	69.9
Risk elements in lending	0.5	0.4	1.6
Provision coverage (2)	69%	93%	52%
Customer deposits (excluding repos)	39.3	46.2	45.1
Bank deposits (excluding repos)	6.5	5.6	11.4
Loan:deposit ratio (excluding repos and conduits)	91%	91%	126%
Risk-weighted assets			
- Credit risk (non-counterparty)	44.3	46.7	38.9
- Operational risk	4.7	5.2	4.3
Total risk-weighted assets	49.0	51.9	43.2
	£m	£m	£m
Run-off businesses (3)			
Total income	1	23	75
Direct expenses	(1)	(31)	(93)
Operating loss	—	(8)	(18)

Notes:
(1) Excludes disposal groups.
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
(3) Run-off businesses consist of the exited corporate finance businesses.

International Banking provides for the needs of its customers through its offering of debt financing, risk management and transaction services across its network. Business conditions remain challenging as themes of low interest rates and margin compression continue. International Banking remained focused on cost discipline throughout 2013 and continued to strengthen its balance sheet. Despite credit model uplifts, risk-weighted assets reduced 6% year on year.

The strength of the division’s efforts in serving its customers’ needs is reflected in recent external industry awards and recognition, including:

- Best Trade Finance Bank, UK, and Best Supply Chain Finance Provider, Western Europe - Global Finance. Global Trade Review magazine’s 'Leaders in Trade' award for Best Bank for Documentary Processing 2013, making this the 4th consecutive win for the bank.

- A good performance in the Euromoney 2013 Cash Management Survey, particularly in Europe, ranking #1 in the Netherlands, #2 in the UK and #2 in Western Europe. International Banking improved on last year's performance in APAC, achieving a #8 ranking, and retained a #9 ranking in North America and a #6 ranking globally.

- Received the 'Most Innovative Investment Bank for Loans' award at The Banker Investment Banking Awards 2013 providing a further indication that RBS is putting customers at the heart of its business.

- Best Debt House, UK - Euromoney.

Business review
International Banking continued
2013 compared with 2012
Operating profit, decreased by £315 million as lower income and higher impairments, including £52 million in relation to the accelerated asset recovery strategy associated with RCR, were only partially offset by lower costs.

Income was 13% lower:
- Cash management was 22% lower reflecting a decline in three-month LIBOR rates as well as increased funding costs of liquidity buffer requirements.

- Loan portfolio decreased by 6%, in line with a smaller balance sheet.

Expenses were down £77 million, or 5%, reflecting continued emphasis on cost control and timely run-off of discontinued business.

Impairment losses were £118 million higher than in 2012, including two large single-name provisions and £52 million in relation to the impact of the accelerated RCR asset recovery strategy.

Third party assets were down 8% due to reductions in the loan portfolio following increased levels of customer repayments partially offset by an increase in Asia trade volume.

Customer deposits declined by 15% in line with a change in Group funding strategy.

Risk-weighted assets decreased by 6% primarily as a result of management action to mitigate credit model increases and a smaller balance sheet.

Return on equity was 4% or 5% excluding the impact of the accelerated RCR asset recovery strategy compared with 9% in 2012.

2012 compared with 2011
Operating profit decreased by £161 million as a decline in income was only partially mitigated by lower expenses and impairment losses.

Income was 17% lower:
- Loan portfolio decreased by 32%, mainly due to a strategic reduction in assets, in order to allocate capital more efficiently, and the effect of portfolio credit hedging and lower corporate appetite for risk management activities.

- Cash management was broadly in line with the previous year. Deposit margins declined following reductions in both three month LIBOR and five year fixed rates across Europe; however, this was offset by lower liquidity costs due to the strategic initiative to reduce short-term bank deposits.

- Trade finance increased by 6% as a result of increased activity, particularly in Asia.

- The restructuring in 2012 led to a reduction in activities undertaken in the division, which contributed to a decline in income.

Expenses declined by £215 million, reflecting planned restructuring initiatives following the formation of the International Banking division. Savings were achieved through headcount reduction, run-off of discontinued businesses and a resulting decrease in infrastructure support costs. Revenue-linked expenses also fell in line with the decrease in income.

Impairment losses decreased by £57 million with the non-repeat of a single name impairment.

Third party assets declined by 24%, with targeted reductions in the lending portfolio following a strategic reduction in assets.

Customer deposits increased by 2%. Successful efforts to rebuild customer confidence following the Moody's credit rating downgrade and the Group technology incident in June 2012 outweighed economic pressures. This, coupled with the managed reduction in loans and advances to customers, improved the loan:deposit ratio to 91%.

Bank deposits were down 51%, mainly as a result of lower short-term balances, reflecting a strategic initiative to reduce liquidity outflow risk.

Risk-weighted assets increased by 20%, reflecting the impact of regulatory uplifts partially offset by successful mitigation through balance sheet reduction. Risk-weighted asset intensity in the loan book has increased significantly given the uplifts, which will result in strategic adjustments going forward.

Ulster Bank

	2013	2012	2011
	£m	£m	£m
Net interest income	631	649	736
Net fees and commissions	141	145	142
Other non-interest income	99	51	69
Non-interest income	240	196	211
Total income	871	845	947
Direct expenses			
- staff	(239)	(214)	(225)
- other	(63)	(49)	(67)
Indirect expenses	(252)	(258)	(255)
	(554)	(521)	(547)
Profit before impairment losses	317	324	400
Impairment losses	(1,774)	(1,364)	(1,384)
Operating loss	(1,457)	(1,040)	(984)
Analysis of income by business			
Corporate	315	360	435
Retail	408	360	428
Other	148	125	84
Total income	871	845	947
Analysis of impairments by sector			
Mortgages	235	646	570
Commercial real estate			
- investment	593	221	225
- development	153	55	99
Other corporate	771	389	434
Other lending	22	53	56
Total impairment losses	1,774	1,364	1,384
Of which RCR related (1)	892	—	—
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector			
Mortgages	1.2%	3.4%	2.9%
Commercial real estate			
- investment	17.4%	6.1%	5.8%
- development	21.9%	7.9%	11.0%
Other corporate	10.9%	5.0%	5.6%
Other lending	1.8%	4.1%	3.5%
Total	5.6%	4.2%	4.1%
Performance ratios			
Return on equity (2)	(32.4%)	(21.8%)	(22.8%)
Net interest margin	1.91%	1.88%	1.87%

Cost:income ratio	64%	62%	58%

Notes:
(1) Pertaining to the creation of RCR and related strategy.
(2) Divisional return on equity is based on divisional operating loss after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

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Business review

Ulster Bank continued

	2013	2012	2011
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)			
- mortgages	19.0	19.2	20.0
- commercial real estate			
- investment	3.4	3.6	3.9
- development	0.7	0.7	0.9
- other corporate	7.1	7.8	7.7
- other lending	1.2	1.3	1.6
	31.4	32.6	34.1
Loan impairment provisions	(5.4)	(3.9)	(2.7)
Net loans and advances to customers	26.0	28.7	31.4
Risk elements in lending			
- mortgages	3.2	3.1	2.2
- commercial real estate			
- investment	2.3	1.6	1.0
- development	0.5	0.4	0.3
- other corporate	2.3	2.2	1.8
- other lending	0.2	0.2	0.2
Total risk elements in lending	8.5	7.5	5.5
Provision coverage (1)	64%	52%	50%
Customer deposits	21.7	22.1	21.8
Loan:deposit ratio (excluding repos)	120%	130%	143%
Risk-weighted assets			
- credit risk			
- non-counterparty	28.2	33.6	33.6
- counterparty	0.3	0.6	0.6
- market risk	0.5	0.2	0.3
- operational risk	1.7	1.7	1.8
Total risk-weighted assets	30.7	36.1	36.3
Spot exchange rate - €/£	1.201	1.227	1.196

Note:

(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

The creation of RCR will expedite the resolution of underperforming, capital intensive assets and allow Ulster Bank to focus on building a stronger core business for the future. The creation of RCR resulted in additional charges of £911 million in Ulster Bank's results in Q4 2013.

Operating performance for 2013, excluding the impact of the creation of RCR, improved by £494 million or 48% versus prior year primarily reflecting higher income and a 64% reduction in mortgage impairment losses driven by enhanced collections effectiveness, the development of programmes to assist customers in financial difficulty and a modest improvement in economic conditions.

Ulster Bank is committed to supporting the Irish economic recovery and £1.7 billion of funding has been made available to support new lending in 2014, £1 billion for business customers and £700 million for personal customers. The bank made considerable progress during 2013 in its commitment to building a really good bank that serves customers well.

Business review
Ulster Bank continued
Simplifying Banking
Ulster Bank delivered a number of improvements for personal and business customers in 2013:

- The launch of initiatives such as "Get Cash", "Pay Your Contacts" and "Emergency Cash" provided a new range of simple and convenient services for customers to access their cash and make payments online and via mobile.

- Further development of online and mobile banking for business customers focused on providing an efficient and effective day-to-day banking service. Enhancements during 2013 included a speedy and simplified account application process; registration for Anytime Banking via telephone; ability to manage personal and business accounts together and access to extended transaction history.

- The efficiency and effectiveness of Ulster Bank's digital offering was evidenced by a 55% increase in mobile app registrations and more than 100 million transactions were carried out via digital channels during 2013. Over 315,000 customers regularly use mobile app banking services and 640,000 customers make regular use of online Anytime banking services.

Supporting Enterprise and the Community:
- Supporting entrepreneurship and the growth of small businesses in the local community is a long term commitment of Ulster Bank. Highlights in 2013 included:

- The Community Impact Fund and Business Woman Can initiative which facilitated women in local communities to set up their own business. The bank also supported a number of projects in schools across the island of Ireland through its MoneySense programme.

- Ulster Bank's dedicated SME teams offer professional support and a range of products to help customers meet their banking challenges and grow their business. The agri–specialist team has introduced a number of initiatives during 2013 to support the farming sector.

- The 'One Week in June' initiative raised £430,000 for a number of Irish charities through a series of fundraising events involving both customers and staff.

- In partnership with Concern Worldwide and Disasters Emergency Committee, Ulster Bank ATMs, branches and online banking facilitated donations to the Philippines Typhoon emergency appeals.

Helping Customers out of Financial Difficulty:
- Ulster Bank is committed to working with all customers in financial difficulty to find a solution. The Bank continued to invest in its Problem Debt Management Unit and further developed a range of solutions to make it easier for customers to enter into arrangements. As a consequence, the number of mortgage customers in arrears of 90 days or more has decreased every month since March 2013.

2013 compared with 2012
Excluding the impact of the creation of RCR, operating result improved by £494 million or 48% primarily due to a higher income and lower impairment losses on the mortgage portfolio.

Total income increased by £26 million or 3% to £871 million primarily reflecting hedging gains on the mortgage portfolio. Net interest margin for 2013 increased by 3 basis points to 1.91% although net interest income was £18 million lower at £631 million, largely driven by lower interest-earning assets and a higher cost of funding.

Total expenses increased by £33 million or 6% to £554 million driven by the costs of mandatory change programmes such as the Single Euro Payment Area, £18 million, an investment of £10 million in programmes to support customers in financial difficulty and an accelerated depreciation charge of £12 million.

Impairment losses, excluding the impact of RCR, were £482 million, 35% lower. This was predominantly due to a sharp reduction in losses on the mortgage portfolio which reduced by £411 million or 64% due to a decline in arrears levels driven by an improved collections performance and the development of programmes to assist customers in financial difficulty, coupled with stabilising residential property prices.

The loan:deposit ratio reduced from 130% to 120% during 2013 reflecting continued customer deleveraging and low levels of demand for new lending. Retail and SME deposit balances increased by 2% during 2013, offset by a reduction in wholesale customer balances, resulting in a 2% decline in total deposit balances.

Risk-weighted assets decreased by 15% reflecting a smaller performing loan book and stabilising credit metrics.

2012 compared with 2011
Operating loss increased by £56 million primarily reflecting a reduction in income driven by lower interest earning asset volumes.

Total expenses fell by £26 million, reflecting the benefits of cost saving initiatives.

Impairment losses remained elevated, as weak underlying credit metrics prevailed. Falling asset values throughout most of 2012 and high levels of unemployment coupled with weak domestic demand continued to depress the property market. The impairment charge for 2012 was driven by a combination of new defaulting customers and deteriorating security values. Risk elements in lending increased by £2 billion during the year reflecting continued difficult conditions in both the commercial and residential property sectors.

The loan to deposit ratio improved from 143% to 130%, driven by a combination of deposit growth and a decrease in the loan book. The loan book decreased by 1% as a result of movements in foreign exchange rates offset by natural amortisation and limited new lending due to low levels of market demand. Retail and SME deposits increased by 8%; however, this was partly offset by outflows of wholesale balances driven by market volatility and the impact of a rating downgrade in the second half of 2011.

Business review

US Retail & Commercial	2013 US$m	2012 US$m	2011 US$m	2013 £m	2012 £m	2011 £m
Net interest income	2,998	3,062	3,015	1,916	1,932	1,879
Net fees and commissions	1,190	1,253	1,368	761	791	853
Other non-interest income	489	584	479	312	368	299
Non-interest income	1,679	1,837	1,847	1,073	1,159	1,152
Total income	4,677	4,899	4,862	2,989	3,091	3,031
Direct expenses						
- staff	(1,667)	(1,605)	(1,620)	(1,065)	(1,013)	(1,010)
- other	(1,521)	(1,609)	(1,674)	(972)	(1,014)	(1,044)
- litigation settlement	—	(138)	—	—	(88)	—
Indirect expenses	(233)	(206)	(184)	(149)	(131)	(114)
	(3,421)	(3,558)	(3,478)	(2,186)	(2,246)	(2,168)
Profit before impairment losses	1,256	1,341	1,384	803	845	863
Impairment losses	(244)	(145)	(524)	(156)	(91)	(326)
Operating profit	1,012	1,196	860	647	754	537
Average exchange rate - US$/£				1.565	1.585	1.604
Analysis of income by product						
Mortgages and home equity	716	856	744	458	540	463
Personal lending and cards	643	637	700	411	402	436
Retail deposits	1,194	1,348	1,465	763	852	914
Commercial lending	1,062	965	936	679	609	584
Commercial deposits	631	689	656	403	434	410
Other	431	404	361	275	254	224
Total income	4,677	4,899	4,862	2,989	3,091	3,031
Analysis of impairments by sector						
Residential mortgages	44	(2)	44	28	(1)	28
Home equity	101	150	165	65	95	103
Corporate and commercial	(36)	(120)	88	(23)	(77)	55
Other consumer	127	104	101	81	65	61
Securities	8	13	126	5	9	79
Total impairment losses	244	145	524	156	91	326
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) by sector						
Residential mortgages	0.5%	—	0.5%	0.5%	—	0.5%
Home equity	0.5%	0.7%	0.7%	0.5%	0.7%	0.7%
Corporate and commercial	(0.1%)	(0.3%)	0.2%	(0.1%)	(0.3%)	0.2%
Other consumer	0.9%	0.8%	0.8%	0.9%	0.8%	0.8%
Total	0.3%	0.2%	0.5%	0.3%	0.2%	0.5%

Performance ratios

Return on equity (1)	7.2%	8.3%	6.3%	7.2%	8.3%	6.3%
Net interest margin	2.95%	2.97%	3.03%	2.95%	2.97%	3.03%
Cost:income ratio	73%	73%	72%	73%	73%	72%

Note:
(1) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions).

US Retail & Commercial continued

	2013 US$bn	2012 US$bn	2011 US$bn	2013 £bn	2012 £bn	2011 £bn
Capital and balance sheet						
Loans and advances to customers (gross)						
- residential mortgages	9.6	9.4	9.4	5.8	5.8	6.1
- home equity	20.1	21.5	23.1	12.1	13.3	14.9
- corporate and commercial	39.8	38.5	35.3	24.1	23.8	22.9
- other consumer	14.1	13.5	12.0	8.6	8.4	7.7
	83.6	82.9	79.8	50.6	51.3	51.6
Loan impairment provisions	(0.4)	(0.5)	(0.7)	(0.3)	(0.3)	(0.5)
Net loans and advances to customers	83.2	82.4	79.1	50.3	51.0	51.1
Total third party assets	118.7	117.7	117.8	71.7	72.8	76.1
Investment securities	21.3	19.5	23.5	12.9	12.0	15.2
Risk elements in lending						
- retail	1.5	1.3	1.0	0.9	0.8	0.6
- commercial	0.2	0.6	0.6	0.1	0.3	0.4
Total risk elements in lending	1.7	1.9	1.6	1.0	1.1	1.0
Provision coverage (1)	26%	25%	45%	26%	25%	45%
Customer deposits (excluding repos)	91.1	95.6	92.8	55.1	59.2	60.0
Bank deposits (excluding repos)	3.3	2.9	8.0	2.0	1.8	5.2
Loan:deposit ratio (excluding repos)	91%	86%	85%	91%	86%	85%
Risk-weighted assets						
- credit risk						
- non-counterparty	83.8	82.0	83.0	50.7	50.8	53.6
- counterparty	0.8	1.4	1.5	0.5	0.8	1.0
- operational risk	8.2	7.9	7.3	4.9	4.9	4.7
	92.8	91.3	91.8	56.1	56.5	59.3
Spot exchange rate - US$/£				1.654	1.616	1.548

Note:
(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.

Business review

US Retail & Commercial continued
On 1 November 2013, RBS announced plans to accelerate its previously announced partial initial public offering of RBS Citizens Financial Group (RBSCFG) into the second half of 2014. RBS intends to fully divest its position in RBSCFG by the end of 2016, leaving it as a standalone regional bank, owned by public shareholders.

RBSCFG has commenced a number of actions in 2013 aimed at improving financial performance. RBSCFG continued to drive profitable growth in its core business by focusing on the customer and delivering a differentiated experience. In addition, RBSCFG has launched a series of initiatives aimed at narrowing the performance gap with competitors, including selectively expanding lending areas where RBSCFG has proven capabilities (such as Mid-Corporate, Specialty Verticals) and selective expansion of risk appetite (moving from super-prime to prime in certain products).

RBSCFG has also launched transformational initiatives in 2013 including:

- A special initiative called Project ‘TOP’, ‘Tapping Our Potential’. The project intends to improve the overall effectiveness and efficiency of the franchise by utilising ideas generated by our colleagues.

- On 7 January 2014, RBSCFG announced the sale of its Chicago-area retail branches, small business operations and select middle market relationships in the Chicago market to U.S. Bank National Association, the lead bank of U.S. Bancorp. RBSCFG will maintain a presence in Chicago through its commercial business lines and several national consumer business lines not included in the sale(1). The sale, expected to close in mid-2014 (subject to regulatory approval), includes 94 Charter One branches in the Chicago area, $5.3 billion in local deposits and $1.1 billion in locally originated loans for a deposit premium of approximately $315 million, or 6%. The proceeds will be reinvested in the remaining franchise, where we have stronger market positions and better long-term growth prospects.

Moreover, RBSCFG continued to grow its core franchise by consistently delivering a differentiated customer experience and leveraging its strong market presence (top 5 deposit market share in 8 of its top 10 Metropolitan Statistical Areas).

In 2013, Consumer Banking continued to improve customer convenience, address the shift in customer preference, and expand its distribution presence. Consumer Banking installed more than 900 intelligent deposit machines (enhanced ATMs), improved the web account opening process, simplified online banking log-in, and released a new mobile application optimised for the iPad. Consumer Banking also implemented a new branch image capture system throughout the network that automates teller processing and offers secure paperless transactions, debit card identification and clear receipts that provide on-the-spot balance availability.

In recognition of the customer experience it offers, Money magazine named Citizens Bank one of the “Best Banks in America” in 2013. In addition to a “robust presence” defined by its many branches and ATMs, Money recognised RBSCFG’s extended branch hours that include seven-day-a-week supermarket branches. Money also noted that RBSCFG’s convenience options also extend to its mobile banking apps for Android and iPhone, which are generating positive customer feedback in the industry. An August report issued by Xtreme Labs noted that “Citizens Bank is the only bank with the highest rated apps on both Android (4.5 stars) and iOS (4.5 stars) platforms”.

The Small Business Banking and Commercial Enterprise Banking divisions were integrated into one consolidated Business Banking division within Consumer Banking, targeting companies with up to $25 million in annual sales. The consolidation will enhance the customer experience, transform sales and service, and align products and processes.

Commercial Banking remained focused on growing and deepening relationships by providing thought leadership and improved product capabilities to clients. Commercial and Industry loan growth was 8.5% compared with the same time period a year ago, which was 1.3% higher than the market(2). The strong results are partially due to the launch of several growth initiatives, which includes expanding our MidCorporate business nationally, as well as growing our Franchise Finance, Lender Finance and other key industry verticals.

Corporate Finance & Capital Markets continued to take market share from both regional competitors and large money centre banks. Commercial Banking moved up in the Overall Middle Market Bookrunner league table from an unranked position in 2009 to #6 by origination volume and #8 by number of transactions in Q4 2013.

Furthermore, the strategic alliance with Oppenheimer allowed Commercial bankers to deliver M&A ideas and solutions that are helping us provide comprehensive solutions to our clients. This alliance won the Barlow Research Associates' Monarch Innovation Award for "Most Innovative Product". The award highlights RBSCFG's commitment to making it easier for middle market companies to develop financial strategies that encompass both commercial banking and investment banking products and services.

As a result of our ongoing focus on providing thought leadership to our clients, our most recent client survey (Q3 2013) showed significant improvement in Middle Market customer satisfaction metrics over the same period a year ago. Net Promoter score increased from 36 to 50, which is well above the peer average of 42. "Proactively Provides Advice and Solutions" score was up from 62% to 85% and lead relationships as a percent of total relationships improved from 51% to 58%. Both metrics are strong indicators of our Commercial bankers' thought leadership capabilities.

Notes:
(1) RBSCFG will continue to operate several businesses in the Chicago market, including the consumer businesses lines of mortgage lending, Education Finance and Auto Finance. RBS Citizens, the bank's commercial banking division, will continue a diverse range of commercial banking operations in Chicago including Asset-Based Lending, Asset Finance, Equipment Leasing, Commercial Real Estate, Treasury Solutions, Capital Markets, Sponsor Finance, Franchise Finance and the majority of its corporate banking business.
(2) Source: SNL Financial. Based on most recent regulatory data as of Q3 2013. Market includes all US banks required to file regulatory reports.

Business review

US Retail & Commercial continued
2013 compared with 2012
Operating profit of £647 million ($1,012 million) was down £107 million ($184 million), or 14%. The operating environment and market conditions remained challenging, with intense competition for loans. An extended period of low short-term rates limited net interest margin expansion and the rise in long-term rates dramatically slowed mortgage refinance volumes.

Net interest income was down 1% at £1,916 million ($2,998 million) due to a smaller investment portfolio, consumer loan run-off and the effect of prevailing economic conditions on asset yields partially offset by the benefit of interest rate swaps, commercial loan growth and favourable funding costs.

Average loans and advances were flat, with commercial loan growth of 5% despite competition for lending opportunities offset by run-off of long-term fixed-rate consumer products.

Average customer deposits were flat, with planned run-off of high priced time deposits and lower wholesale deposits offset by growth achieved in checking and money market balances. Consumer checking balances grew by 3% while small business checking balances grew by 7% over the year.

Excluding the £47 million ($75 million) gross gain on the sale of Visa B shares in 2012, non-interest income was down £39 million ($83 million), or 4% at £1,073 million ($1,679 million), reflecting lower mortgage banking fees as refinancing volumes have slowed, and lower deposit fees. This was partially offset by higher securities gains and commercial banking fee income.

Excluding the £88 million ($138 million) litigation settlement in 2012 relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010 and the £8 million ($13 million) litigation reserve associated with the sale of Visa B shares, total expenses of £2,186 million ($3,421 million) were broadly in line with prior year. This largely reflects a mortgage servicing rights impairment recapture driven by the increase in long-term rates offset by the cost of regulatory compliance and new technology investments and a one-off £21 million ($33 million) pension gain in 2012.

Impairment losses increased by £65 million ($99 million) to £156 million ($244 million) for the year and represented 0.3% of loans and advances to customers.

2012 compared with 2011
US Retail & Commercial posted an operating profit of £754 million ($1,196 million), up £217 million ($336 million), or 40%, from 2011. Excluding the £88 million ($138 million) litigation settlement in Q1 2012 and the £39 million ($62 million) net gain on the sale of Visa B shares in Q2 2012, operating profit was up £266 million ($412 million), or 50%, largely reflecting lower impairment losses due to an improved credit environment.

Net interest income was up £53 million ($47 million), or 3%, driven by targeted commercial loan growth, deposit pricing discipline and lower funding costs. This was partially offset by consumer loan run-off and lower asset yields reflecting prevailing economic conditions.

Non-interest income was up £7 million. In US dollar terms non-interest income was down $10 million, or 1%, reflecting a decline in debit card fees as a result of the Durbin Amendment legislation and lower securities gains and deposit fees. This was largely offset by strong mortgage banking fees of £69 million ($109 million), up 71%, and the £47 million ($75 million) gross gain on the sale of Visa B shares.

Gross loans and advances to customers were down £0.3 billion. In US dollar terms loans and advances to customers were up $3.1 billion, or 4%, due to strong growth in commercial loan volumes.

Customer deposits decreased by 1% as a result of movements in foreign exchange rates partially offset by strong growth achieved in checking balances. Consumer checking balances fell by 1% while small business checking balances grew by 4% over the year.

Excluding the £88 million ($138 million) litigation settlement, relating to a class action lawsuit regarding the way overdraft fees were assessed on customer accounts prior to 2010, and the £8 million ($13 million) litigation reserve associated with the sale of Visa B shares, and a one-off £21 million ($33 million) pension gain in Q4 2012, total expenses were down 1%, reflecting lower loan collection costs and the elimination of the Everyday Points rewards programme for consumer debit card customers, partially offset by higher operational losses.

During the year, RBS Citizens offered former employees a one-time opportunity to receive the value of future pension benefits as a single lump sum payment. The transaction allowed RBS Citizens to partially de-risk its pension plan and future liability under the plan. A strong participant take-up rate of 60% enabled RBS Citizens to reduce its pension liability by 17% and recognise a £21 million ($33 million) accounting gain.

Impairment losses were down £235 million ($379 million), or 72%, reflecting an improved credit environment and lower impairments on securities. Loan impairments improved by £168 million ($266 million) driven primarily by commercial loan impairments. Impairments as a percentage of loans and advances fell to 20 basis points.

Business review

Markets	2013	2012	2011
	£m	£m	£m
Net interest income	157	111	67
Net fees and commissions receivable	75	128	371
Income from trading activities	3,057	4,105	3,846
Other operating income	33	139	131
Non-interest income	3,165	4,372	4,348
Total income	3,322	4,483	4,415
Direct expenses			
- staff	(1,177)	(1,453)	(1,959)
- other	(723)	(722)	(748)
Indirect expenses	(710)	(762)	(771)
	(2,610)	(2,937)	(3,478)
Profit before impairment losses	712	1,546	937
Impairment losses (1)	(92)	(37)	(38)
Operating profit	620	1,509	899
Of which:			
Ongoing businesses (2)	655	1,431	523
Run-off and recovery businesses	(35)	78	376
Analysis of income by product			
Rates	1,053	1,922	1,459
Currencies	1,000	775	1,129
Asset-backed products (ABP)	943	1,322	1,221
Credit markets	699	735	461
Total income ongoing businesses	3,695	4,754	4,270
Inter-divisional revenue share	(612)	(708)	(828)
Run-off and recovery businesses	239	437	973
Total income	3,322	4,483	4,415
Memo - fixed income and currencies			
Total income ongoing businesses	3,695	4,754	4,270
Less: primary credit markets	(561)	(574)	(683)
Total fixed income and currencies	3,134	4,180	3,587
Performance ratios			
Return on equity (3)	5.0%	9.6%	5.9%
Cost:income ratio	79%	66%	79%
Compensation ratio (4)	35%	32%	44%

Notes:
(1) Includes £18 million pertaining to the creation of RCR and related strategy.
(2) The ongoing businesses include the Rates, Currencies, Asset backed products and credit markets areas.
(3) Divisional return on equity is based on divisional operating profit after tax divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for the ongoing businesses.
(4) Compensation ratio is based on staff costs as a percentage of total income.

Markets continued

	2013	2012	2011
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross)	25.4	29.8	31.5
Loan impairment provisions	(0.2)	(0.2)	(0.2)
Net loans and advances to customers	25.2	29.6	31.3
Net loans and advances to banks	12.5	16.6	29.9
Reverse repos	76.2	103.8	100.5
Securities	69.8	92.4	108.4
Cash and eligible bills	20.3	30.2	28.1
Other	8.8	11.9	15.7
Total third party assets (excluding derivatives mark-to-market)	212.8	284.5	313.9
Net derivative assets (after netting)	15.5	21.9	37.0
Provision coverage (1)	85%	77%	75%
Customer deposits (excluding repos)	21.5	26.3	36.8
Bank deposits (excluding repos)	23.8	45.4	48.2
Risk-weighted assets			
- credit risk			
- non-counterparty	10.8	14.0	16.7
- counterparty	17.5	34.7	39.9
- market risk	26.4	36.9	50.6
- operational risk	9.8	15.7	13.1
Total risk-weighted assets	64.5	101.3	120.3
Income statement (ongoing business)	£m	£m	£m
Total income	3,094	4,076	3,507
Direct expenses	(1,750)	(1,902)	(2,220)
Indirect expenses	(682)	(753)	(762)
Impairment (losses)/recoveries	(7)	10	(2)
Operating profit	655	1,431	523
Performance ratios (ongoing business)			
Return on equity (2)	6.8%	11.5%	4.3%
Cost:income ratio	79%	65%	85%
Compensation ratio (3)	35%	31%	46%
Balance sheet (ongoing businesses)	£bn	£bn	£bn
Total third party assets (excluding derivatives mark-to-market)	198.8	259.3	278.6
Risk-weighted assets	52.1	79.1	95.5

Notes:
(1) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
(2)

Divisional return on equity is based on divisional operating profit after tax, divided by average notional equity (based on 10% of the monthly average of divisional RWAs, adjusted for capital deductions), for ongoing businesses.

(3) Compensation ratio is based on staff costs as a percentage of total income.

Markets continued
In 2013, Markets launched and executed a strategic repositioning of the business, aimed at reducing risk, tightening controls, consolidating the geographic footprint and reducing complexity by refocusing on the franchise's core strengths in fixed income products. The division met or exceeded all internal targets for reducing controllable costs, risk weighted assets and balance sheet, while meeting revenue and operating profit expectations. Controls were enhanced, trading was integrated into four financial hubs, the front-to-back operating model was simplified and an agreement was reached for the sale of the Investor Products and Equity Derivatives business. Market share in the four core product areas (Rates, Currencies, Asset Backed Products and Credit) remained broadly stable with high profile client transactions executed across the globe. As a result of the strategic repositioning, Markets ended 2013 better positioned for the changing regulatory and external environment.

Lower income in 2013 compared with 2012 reflected both the strategic scaling back of the balance sheet and risk reduction in a difficult market environment. Client activity was limited by the uncertainty that surrounded the much anticipated tapering of the Federal Reserve's programme of quantitative easing. This contrasted with 2012 when markets were boosted by the European Central Bank's Long Term Refinancing Operation. Nevertheless, Markets' core businesses remained resilient and continued to produce positive results. Currencies income increased significantly year on year and Corporate Debt Capital Markets reaffirmed its leading position in the GBP market.

2013 compared with 2012
Operating profit fell by £889 million with income falling by 26%, partly offset by significant cost reductions. The de-risking of Markets resulted in a 36% reduction in risk-weighted assets.

Rates actively repositioned the business during 2013, lowering the balance sheet and reducing risk. This, combined with a weak trading performance in H1 2013, resulted in subdued returns.

Currencies income increased as the franchise remained resilient and FX Options benefited from opportunities in volatile FX and emerging markets.

Asset Backed Products continued to perform well, although income was affected by investor concerns regarding tapering of the Federal Reserve's programme of quantitative easing and a reduction in the balance sheet and risk resources deployed by the business.

Credit Markets reflected the previous year's de-risking of credit trading and witnessed a modest reduction in Debt Capital Markets income, although the business executed a number of significant transactions and retained its leading position in corporate GBP issuance.

Costs fell by 11%, reflecting a reduction in headcount of 1,000 – split evenly between the front and back-office - and tightly controlled discretionary expenses, although this was offset by a higher level of legal costs, primarily related to legacy issues in the US Asset Backed Products business.

The increase in impairments was driven predominantly by provisions against a single exposure in 2013.

Reducing risk and refocusing the division on core fixed income and currencies products drove a substantial reduction in both balance sheet and risk capital. Third party assets were £72 billion lower than 31 December 2012 and risk-weighted assets, at £65 billion, were down £37 billion.

2012 compared with 2011

Operating profit increased by 68% reflecting 2% growth in income and 20% decrease in direct expenses, most notably through a reduction in staff costs.

Rates benefited from a strong trading performance, while losses incurred in managing counterparty exposures during the third quarter of 2011 were not repeated during 2012. Revenues for the year were up 32% to £1.9 billion.

Currencies volumes were weak across the industry, although the Spot FX business minimised the impact on revenue. Options income was limited by further Eurozone uncertainty.

Asset Backed Products continued to perform strongly as markets were sustained throughout the year by investors' search for yield. Revenues for the year were £1.3 billion, up 8% from a strong performance of £1.22 billion in 2011.

A 59% increase in Credit Markets revenue to £735 million was driven by Flow Credit which, as a result of improved risk management and more benign market conditions, recorded good profitability compared with a loss in 2011. This was partially offset by weaker earnings from credit origination.

The division focused on controlling costs throughout 2012, driving total expenses down by 16%. Lower staff expenses, down 26%, reflect lower headcount and lower levels of variable compensation, including reductions and clawbacks following the Group's LIBOR settlements reached on 6 February 2013, with the compensation ratio falling from 44% to 32%. Headcount reductions totalled 2,700 in the year, including that resulting from the exit of businesses announced in January. Other expenses fell by 3% as rigorous controls on discretionary expenditure and the exiting of product areas continued to take effect, partially offset by higher legal expenses.

The reduction in third party assets reflected management action to optimise and de-risk the balance sheet, consistent with previously disclosed medium-term objectives.

The division reduced risk-weighted assets, successfully focusing on lowering risk and enhancing models whilst managing the requirement for greater prudence in the regulatory environment.

Not reflected in Markets operating results in 2012 were the following items: £381 million for regulatory fines; £350 million for its share of the provision for interest rate swap redress; and approximately £700 million in restructuring costs associated with the strategic changes that took place during 2012.

Central items	2013	2012	2011
	£m	£m	£m
Central items not allocated	(89)	84	(34)

Funding and operating costs have been allocated to operating divisions, based on direct service usage, requirement for market funding and other appropriate drivers where services span more than one division.

Residual unallocated items relate to volatile corporate items that do not naturally reside within a division.

2013 compared with 2012
Central items not allocated, represented a debit of £89 million in 2013 compared with a credit of £84 million in 2012, a reduction of £173 million.

This has been principally driven by higher unallocated Treasury and funding costs, £175 million higher, including volatile items under IFRS and lower gains on Treasury available-for-sale securities, down £156 million from £880 million in 2012 to £724 million in 2013.

Central items included various legacy litigation and conduct provisions totalling £127 million for 2013, a reduction of £33 million compared with 2012, and a property-related impairment of £65 million which have been offset by the non-repeat of £175 million costs incurred in 2012 in relation to the technology incident and credits totalling £80 million recognised in relation to the Group's share of profit from its stake in Saudi Hollandi, which was held as a disposal group in 2012.

2012 compared with 2011
Central items not allocated represented a credit of £84 million compared with a debit of £34 million in 2011.

Significant central costs included the Group technology incident cost of £175 million, a £160 million provision for various litigation and legacy conduct issues, as well as unallocated Treasury costs of circa £390 million. VAT recoveries of £85 million and Group Pension fund adjustment of circa £50 million in 2011 were not repeated.

Offsetting these costs, profits on Group Treasury available-for-sale bond disposals totalled £880 million compared with £516 million in 2011, as active management of the liquid assets portfolio as well as favourable market conditions enabled the Group to crystallise gains on some holdings.

Business review

Non-Core	2013	2012	2011
	£m	£m	£m
Net interest income	(61)	346	828
Funding costs of rental assets	(38)	(102)	(215)
Net interest income	(99)	244	613
Net fees and commissions	55	105	54
Loss from trading activities	(148)	(654)	(721)
Other operating income			
- rental income	177	510	953
- other (1)	(331)	83	75
Non-interest income	(247)	44	361
Total income	(346)	288	974
Direct expenses			
- staff	(203)	(276)	(376)
- operating lease depreciation	(76)	(246)	(347)
- other	(128)	(164)	(240)
Indirect expenses	(198)	(258)	(313)
	(605)	(944)	(1,276)
Loss before impairment losses	(951)	(656)	(302)
Impairment losses	(4,576)	(2,223)	(3,917)
Operating loss	(5,527)	(2,879)	(4,219)
Analysis of (loss)/income by business			
Banking & portfolios	(496)	40	1,251
International businesses	51	250	411
Markets	99	(2)	(688)
Total income	(346)	288	974
Loss from trading activities			
Monoline exposures	(46)	(205)	(670)
Credit derivative product companies	(5)	(205)	(85)
Asset-backed products (2)	103	101	29
Other credit exotics	32	(28)	(175)
Equities	2	(2)	(11)
Banking book hedges	3	(38)	(1)
Other	(237)	(277)	192
	(148)	(654)	(721)
Impairment losses			
Banking & portfolios	4,646	2,346	3,831
International businesses	1	56	82
Markets	(71)	(179)	4
Total impairment losses	4,576	2,223	3,917
Of which RCR related (3)	3,118	—	—
Loan impairment charge as % of gross customer loans and advances (excluding reverse repurchase agreements) (4)			

Banking & portfolios	12.9%	4.2%	4.9%
International businesses	0.5%	5.1%	3.7%
Markets	—	—	(3.0%)
Total	12.8%	4.2%	4.8%

Notes:
(1) Includes losses on disposals of £221 million for 2013 (2012 - £14 million; 2011 - £127 million).
(2) Asset-backed products include super asset backed structures and other asset-backed products.
(3) Pertaining to the creation of RCR and related strategy.
(4) Includes disposal groups.

Business review

Non-Core continued

	2013	2012	2011
Performance ratio			
Net interest margin	(0.19%)	0.31%	0.60%
	£bn	£bn	£bn
Capital and balance sheet			
Loans and advances to customers (gross) (1)	35.6	55.4	79.4
Loan impairment provisions	(13.8)	(11.2)	(11.5)
Net loans and advances to customers	21.8	44.2	67.9
Total third party assets (excluding derivatives)	28.0	57.4	92.5
Total third party assets (including derivatives)	31.2	63.4	103.6
Risk elements in lending (1)	19.0	21.4	24.0
Provision coverage (2)	73%	52%	48%
Customer deposits (1)	2.2	2.7	3.5
Risk-weighted assets			
- credit risk			
- non-counterparty	21.0	45.1	65.6
- counterparty	3.7	11.5	20.2
- market risk	3.3	5.4	13.0
- operational risk	1.2	(1.6)	(5.5)
Total risk-weighted assets	29.2	60.4	93.3
Gross customer loans and advances			
Banking & portfolios	35.4	54.5	77.3
International businesses	0.2	0.9	2.0
Markets	—	—	0.1
	35.6	55.4	79.4
Risk-weighted assets			
Banking & portfolios	26.2	53.3	64.8
International businesses	0.7	2.4	4.1
Markets	2.3	4.7	24.4
	29.2	60.4	93.3
Third party assets (excluding derivatives)			
Banking & portfolios	25.9	51.1	80.1
International businesses	0.3	1.2	2.9
Markets	1.8	5.1	9.5
	28.0	57.4	92.5

For the notes to this table refer to the following page.

Business review

Non-Core continued

Third party assets (excluding derivatives)	31 December 2012 £bn	Run-off £bn	Disposals/ restructuring £bn	Drawings/ roll overs £bn	Impairments £bn	Foreign exchange £bn	31 December 2013 £bn
Commercial real estate	22.1	(5.3)	(2.3)	0.2	(4.1)	0.3	10.9
Corporate	25.5	(8.2)	(4.6)	0.8	(0.3)	(0.2)	13.0
SME	1.0	(0.5)	(0.2)	—	—	—	0.3
Retail	3.2	(0.6)	(0.6)	—	(0.2)	—	1.8
Other	0.5	(0.3)	—	—	—	—	0.2
Markets	5.1	(0.3)	(3.0)	—	—	—	1.8
Total (3)	57.4	(15.2)	(10.7)	1.0	(4.6)	0.1	28.0

Notes:
(1) Excludes disposal groups.
(2) Provision coverage percentage represents loan impairment provisions as a percentage of risk elements in lending.
(3) Disposals of £0.8 billion have been signed as at 31 December 2013 but are pending completion (2012 and 2011 - £0.2 billion).

Commercial real estate third party assets	2013 £bn	2012 £bn	2011 £bn
UK (excluding NI)	4.7	8.9	11.4
Ireland (ROI and NI)	2.3	5.8	7.7
Spain	0.8	1.4	1.8
Rest of Europe	2.8	4.9	7.9
USA	0.3	0.9	2.2
RoW	—	0.2	0.5
Total (excluding derivatives)	10.9	22.1	31.5

Business review

Non-Core continued

Impairment losses by donating division and sector	2013 £m	2012 £m	2011 £m
UK Retail			
Mortgages	—	—	5
Personal	(1)	4	(27)
Total UK Retail	(1)	4	(22)
UK Corporate			
Manufacturing and infrastructure	60	19	76
Property and construction	228	88	224
Transport	40	16	52
Financial institutions	(8)	(38)	5
Lombard	(4)	48	75
Other	40	107	96
Total UK Corporate	356	240	528
Ulster Bank			
Mortgages			
Commercial real estate			
- investment	837	288	609
- development	1,836	611	1,552
Other corporate	345	77	173
Other EMEA	9	7	15
Total Ulster Bank	3,027	983	2,349
US Retail & Commercial			
Auto and consumer	55	49	58
Cards	—	1	(9)
SBO/home equity	83	130	201
Residential mortgages	12	21	16
Commercial real estate	9	(12)	40
Commercial and other	(3)	(12)	(3)
Total US Retail & Commercial	156	177	303
International Banking			
Manufacturing and infrastructure	(42)	3	57
Property and construction	835	623	752
Transport	26	199	(3)
Telecoms, media and technology	24	32	68
Banking and financial institutions	(49)	(58)	(98)
Other	245	18	(19)
Total International Banking	1,039	817	757
Other			
Wealth	(1)	1	1

Central items	—	1	1
Total Other	(1)	2	2
Total impairment losses	4,576	2,223	3,917
Of which RCR related (1)	3,118	—	—

Note:
(1) Pertaining to the creation of RCR and related strategy.

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Non-Core continued

Gross loans and advances to customers (excluding reverse repurchase agreements) by donating division and sector	2013 £bn	2012 £bn	2011 £bn
UK Retail			
Mortgages	—	—	1.4
Personal	—	—	0.1
Total UK Retail	—	—	1.5
UK Corporate			
Manufacturing and infrastructure	—	0.1	0.1
Property and construction	1.7	3.6	5.9
Transport	2.7	3.8	4.5
Financial institutions	—	0.2	0.6
Lombard	0.2	0.4	1.0
Other	1.2	4.2	7.5
Total UK Corporate	5.8	12.3	19.6
Ulster Bank			
Commercial real estate			
- investment	3.2	3.4	3.9
- development	6.9	7.6	8.5
Other corporate	1.5	1.6	1.6
Other EMEA	—	0.3	0.4
Total Ulster Bank	11.6	12.9	14.4
US Retail & Commercial			
Auto and consumer	0.2	0.6	0.8
Cards	—	—	0.1
SBO/home equity	1.5	2.0	2.5
Residential mortgages	0.3	0.4	0.6
Commercial real estate	0.2	0.4	1.0
Commercial and other	0.1	0.1	0.4
Total US Retail & Commercial	2.3	3.5	5.4
Markets			
Manufacturing and infrastructure	1.4	3.9	6.6
Property and construction	7.5	12.3	15.3
Transport	1.4	1.7	3.2
Telecoms, media and technology	0.8	0.4	0.7
Banking and financial institutions	2.9	4.7	5.6
Other	1.9	3.7	7.0
Total Markets	15.9	26.7	38.4
Other			
Wealth	—	—	0.2
Central items	—	—	(0.2)

Total Other	—	—	—
Gross loans and advances to customers (excluding reverse repurchase agreements)	35.6	55.4	79.3

Business review

Non-Core continued
Non-Core has successfully achieved and surpassed its five year Strategic Plan target, reducing third party assets from the opening £258 billion position to end 2013 significantly below the original c.£40 billion target at £28 billion. Over the life of Non-Core this represents an overall reduction of £230 billion, or 89%. This was achieved through a mixture of disposals, run-off and impairments. By the end of 2013, the Non-Core funded balance sheet was c.4% of the Group's funded balance sheet compared with 21% when the division was created. RWAs have reduced from £171 billion to £29 billion, or 83%, over the life of Non-Core.

Third party assets were reduced by £29 billion, or 51%, during the year. Approximately £3.1 billion of the reduction was due to increased impairments as a result of the change in the future run-down/disposal plan for the remaining Non-Core assets under the transition to RCR.

2013 is the final reporting period for the Non-Core division. Approximately £12 billion of assets which were managed by Non-Core are to be returned to the relevant Core divisions, with the remaining assets transferring to RCR from 1 January 2014.

2013 compared with 2012
Third party assets declined by £29 billion, or 51%, reflecting run-off of £15 billion, disposals of £11 billion and impairments of £5 billion, of which £3.1 billion is driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans.

Risk-weighted assets were £31 billion lower, driven by disposals and run-off.

Operating loss of £5,527 million was £2,648 million higher than 2012, principally due to a £2,353 million increase in impairments. This was predominantly due to £3,118 million of 2013 impairments related to the creation of RCR, most significantly with £2,299 million in Ulster Bank and £742 million in International Banking, driven by the new RCR strategy to exit these assets over a shorter timeframe than previous plans, which has led to increased impairment losses on the non-performing assets.

Operating loss before impairment losses was £295 million higher with a reduction in net interest income of £343 million, £207 million additional disposal losses and £104 million further fair value writedowns offset by £506 million lower losses from trading activities.

The reduction in net interest income of £343 million was driven by a 31% fall in interest earning assets driven by run-off and disposals.

Headcount declined by 1,700, or 55% to 1,400 of which 1,000 relates to operations in India and Romania, reflecting divestment activity and run-off.

2012 compared with 2011
Third party assets declined by £35 billion, or 38%, largely reflecting disposals of £18 billion and run-off of £16 billion. The disposal of RBS Aviation Capital in Q2 2012 contributed c.£5 billion of this reduction.

Risk-weighted assets were £33 billion lower, principally driven by disposals, run-off and restructuring of existing positions.

An operating loss of £2,879 million was £1,340 million lower than 2011, principally due to lower impairments and expenses, partially offset by lower net interest income following run-off and disposals.

Impairment losses fell by £1,694 million to £2,223 million, with £1,366 million of this reduction from the Ulster Bank portfolio and £269 million from the real estate portfolio.

Income declined by £686 million as continued divestment and run-off reduced net interest income. Rental income was lower following the disposal of RBS Aviation Capital in Q2 2012.

Expenses were £332 million lower, driven by reduced headcount and lower operating lease depreciation, principally following the disposal of RBS Aviation Capital.

Headcount declined by 29% to 2,900 reflecting the divestment activity and run-off across the business.

Business review

RBS Capital Resolution
Background
In June 2013, in response to a recommendation by the Parliamentary Commission on Banking Standards, the UK Government announced it would review the case for an external ‘bad bank’, based on three objectives as originally outlined by the Chancellor:

- accelerating the return of RBS to the private sector;
- supporting the British economy; and
- best value for the taxpayer.

Following this announcement, RBS worked closely with HM Treasury (‘HMT’) and its advisers to identify a pool of assets with particularly high long-term capital intensity, credit risk, low returns and/or potential stress loss in varying scenarios. The balance of this identified pool was £47 billion as at 30 June 2013. The pool was forecast to be c.£38 billion of assets as at 31 December 2013, which together with derivatives were forecast to attract c.£116 billion of RWA equivalents(1).

HMT published its report on 1 November 2013. The review concluded that the effort, risk and expense involved in the creation of an external bad bank could not be justified. It also concluded that “RBS’s existing provisions and levels of capital deducted suggested that projected future losses are appropriately covered”.

As a result, and in line with its new strategic direction set out on 1 November 2013, RBS announced the creation of RBS Capital Resolution (‘RCR’) to separate and wind down RBS’s high capital intensive assets. RCR will bring assets under common management and was established with the following principles:

- removing risk from the balance sheet in an efficient, expedient and economic manner;

- reducing the volatile outcomes in stressed environments; and

- accelerating the release of capital through management and exit of the portfolio.

The RCR division created with effect from 1 January 2014 is of a similar size to the ex Non-Core division, but the assets were selected on a different basis and no direct comparisons should be drawn. RCR assets were selected on the basis of long term capital intensity whereas the Non-Core assets were selected based on five strategic tests.

Going forward, as part of its external reporting, the Group will provide comprehensive and transparent disclosures on the progress of RCR, including funding and capital employed and released. Furthermore, a Board Oversight Committee (‘BOC’) has been set up reporting directly to the Group Board, to report on adherence to asset management principles and recommend changes to strategy where appropriate. The BOC comprises a quorum of any two of the Chairman of the Group Board, the Senior Independent Director, the Chair of the Group Audit Committee and the Chair of the Board Risk Committee.

While there are inevitable uncertain market and execution risks associated with running down such assets, it is RBSs aspiration, subject to shareholder value, to remove most of these assets and capital from the balance sheet in three years. RCR will target a reduction in funded assets to c.£23 billion by the end of 2014; to between £15 billion and £11 billion by the end of 2015 and to less than £6 billion by the end of 2016. RCR is expected to be Common Equity Tier 1 (‘CET1’) accretive over its life and is neutral for shareholder value, taking into account future regulatory capital requirements.

The RCR pool of assets was forecast to be c.£38 billion and c.£116 billion RWAe at its inception on 1 January 2014 based on 30 June 2013 data. Since this forecast was made:

- £4.6 billion of impairments and other adjustments were recorded in respect of non-performing and other assets as a result of the change in realisation strategy noted above, with capital impact of £37 billion RWAe. The increased impairments relate to certain of the impaired or non-performing assets transferred to RCR, and reflect the revised holding strategy which has led to adverse changes in our estimates of future cash flows.

- there were materially higher levels of disposal activity and recoveries (£5 billion) in Non-Core than had been forecast based on 30 June 2013 data, with a capital impact of £14 billion reduction in RWAe.

In aggregate, these two factors reduced the opening funded assets by £9 billion to £29 billion and RWAe by £51 billion to £65 billion. This reduction is funded assets in the second half of the year, particularly the disposals, has also resulted in a corresponding decrease in the Group’s funding requirements.

At 1 January 2014, 48% of the portfolio’s funded assets are from Non-Core (excluding Ulster Bank), 17% from Ulster Bank (Core and Non-Core) and the remainder are from UK Corporate, International Banking and Markets.

£12 billion of assets with RWAe of £11 billion managed by Non-Core have been returned to the relevant Core divisions because they did not meet the risk and capital criteria for RCR.

RCR commenced on 1 January 2014 and its first results will be reported separately in the Group’s first quarter 2014 results.

Note:
(1) RWA equivalent (RWAe) is an internal metric that measures the equity capital employed in divisions. RWAe converts both performing and non-performing exposures into a consistent capital measure, being the sum of the regulatory RWAs and the regulatory capital deductions, the latter converted to RWAe by applying a multiplier. The Group applies a CET 1 ratio of 10%, consistent with that used for divisional return on equity measure; this results in an FLB3 RWAe conversion multiplier of 10.

RBS Capital Resolution continued

Roll forward of funded assets

	Note	£bn
Estimated balance at 30 June 2013		46.8
Disposals	(a)	(6.0)
Run-off	(b)	(4.8)
Impairments	(c)	(5.2)
Other	(d)	(1.9)
Balance at 31 December 2013		28.9

Notes

(a) disposals in the second half of the year, predominantly in Non-Core.

(b) represents repayments and amortisations, partially offset by draw down of facilities across the portfolios.

(c) includes all impairments in the second half of 2013, predominately in Non-Core, and reflects increased impairments relating to the creation of RCR and the related strategy.

(d) other includes fair value adjustments, foreign exchange movements (£1.2 billion) and finalisation of the asset pool.

Roll forward of FLB3 RWAe

	Note	£bn
Estimated balance at 30 June 2013		136.8
Disposals	(a)	(11.9)
Run-off	(b)	(10.9)
Impairments	(c)	(45.1)
Other	(d)	(3.9)
Balance at 31 December 2013		65.0

Notes:

(a) includes all aspects relating to disposals including associated removal of deductions from regulatory capital.

(b) represents RWAe on repayments and amortisations, partially offset by draw down of facilities across the portfolios.

(c) RWAe impairment charge.

(d) other includes fair value adjustments; changes to inputs for RWA calculation (including LGD, PD, and slotting category); the implementation of a new RWA model or modification of an existing model approved by the PRA, foreign exchange movements and finalisation of the asset pool.

The £18 billion decrease in funded assets in the second half of the year resulted in a significantly higher reduction of £72 billion in RWAe. This was due to:

- impairments of £5 billion recognised in the second half of 2013 resulted in a lower capital deduction for the excess of expected loss over provisions. Allowing for a restriction in provisions allowable against expected losses, the benefit was £4.5 billion or £45 billion of RWAe.
- disposals of £6 billion resulting in RWAe of £12 billion
- run-off of £5 billion with a corresponding RWAe of £11 billion

Capital deductions comprised expected losses less impairment provisions (31 December 2013 - £1,774 million; 30 June 2013 - £6,047 million) and allocation of defined pension fund deficit (31 December 2013 - £58 million; 30 June 2013 - £38 million).

Additional details are set out on the following pages.

RBS Capital Resolution continued

The impact of the revised strategy on key metrics of the Group are set out below.

	Group £bn	RCR £bn	Rest of the Group £bn
Funded assets			
Non-Core	28.0	16.2	11.8
Ulster Bank	28.0	2.5	25.5
UK Corporate	105.0	5.3	99.7
International Banking	48.5	2.2	46.3
Markets	212.8	2.7	210.1
Other divisions	317.5	—	317.5
	739.8	28.9	710.9
Risk elements in lending	£m	£m	£m
Non-Core	19.0	17.2	1.7
Ulster Bank	8.5	3.8	4.7
UK Corporate	6.2	2.3	3.9
International Banking	0.5	0.5	—
Markets	0.3	0.3	—
Other divisions	4.9	—	4.9
	39.4	24.2	15.2
Impairment provision	£m	£m	£m
Non-Core	13.8	13.0	0.8
Ulster Bank	5.4	2.2	3.2
UK Corporate	2.8	0.9	1.9
International Banking	0.3	0.2	0.1
Markets	0.3	0.3	—
Other divisions	2.6	—	2.6
	25.2	16.6	8.6

Business review

RBS Capital Resolution continued

Estimated funded assets (third party assets excluding derivatives or TPA) and RWAe of RCR

Analysis of the funded assets and RWAe of RCR at 31 December 2013 and the related position at 30 June 2013 (the starting point for the identification of the portfolios of RCR), are set out below.

	Non-performing (1)					Performing (1)					Total				
	Gross TPA	Net TPA	RWAe	RWA	Capital deducts	Gross TPA	Net TPA	RWAe	RWA	Capital deducts (2)	Gross TPA	Net TPA	RWAe	RWA	Capital deducts
31 December 2013	£bn	£bn	£bn	£bn	£m	£bn	£bn	£bn	£bn	£m	£bn	£bn	£bn	£bn	£m
Non-Core	18.4	5.8	4.7	0.5	413	10.8	10.4	21.5	23.2	(170)	29.2	16.2	26.2	23.7	243
Core															
Ulster Bank	3.9	1.8	6.3	0.2	610	0.8	0.7	1.9	1.9	3	4.7	2.5	8.2	2.1	613
UK Corporate	2.3	1.6	3.5	—	353	3.9	3.7	8.0	8.0	—	6.2	5.3	11.5	8.0	353
International Banking	0.5	0.4	1.8	—	178	1.9	1.8	4.5	4.3	23	2.4	2.2	6.3	4.3	201
Markets	0.4	0.1	0.9	—	91	2.6	2.6	11.9	8.6	331	3.0	2.7	12.8	8.6	422
Total Core	7.1	3.9	12.5	0.2	1,232	9.2	8.8	26.3	22.8	357	16.3	12.7	38.8	23.0	1,589
Total RCR	25.5	9.7	17.2	0.7	1,645	20.0	19.2	47.8	46.0	187	45.5	28.9	65.0	46.7	1,832
30 June 2013															
Non-Core	22.3	11.8	39.4	2.2	3,716	17.9	17.9	31.6	38.4	(666)	40.2	29.7	71.0	40.6	3,050
Core															
Ulster Bank	5.1	2.8	12.9	0.8	1,207	1.4	1.4	5.2	3.8	149	6.5	4.2	18.1	4.6	1,356
UK Corporate	2.9	2.5	7.9	—	762	4.6	4.6	12.3	9.6	265	7.5	7.1	19.9	9.6	1,027
International Banking	0.9	0.6	3.2	—	323	2.4	2.4	4.8	4.2	59	3.3	3.0	8.0	4.2	382
Markets	—	—	—	—	—	2.8	2.8	19.8	17.1	270	2.8	2.8	19.8	17.1	270
Total Core	8.9	5.9	23.7	0.8	2,292	11.2	11.2	42.1	34.7	743	20.1	17.1	65.8	35.5	3,035
Total RCR	31.2	17.7	63.1	3.0	6,008	29.1	29.1	73.7	73.1	77	60.3	46.8	136.8	76.1	6,085

Notes

(1) Performing assets are those with an internal asset quality (AQ) of 1-9; and non-performing assets are in AQ 10 with a probability of default being 100%.

(2) The negative capital deductions are a result of the latent loss provisions held in respect of the performing portfolio.

Business review

Consolidated balance sheet at 31 December 2013

	2013	2012*	2011*
	£m	£m	£m
Assets			
Cash and balances at central banks	82,659	79,290	79,269
Net loans and advances to banks	27,555	29,168	43,870
Reverse repurchase agreements and stock borrowing	26,516	34,783	39,440
Loans and advances to banks	54,071	63,951	83,310
Net loans and advances to customers	390,825	430,088	454,112
Reverse repurchase agreements and stock borrowing	49,897	70,047	61,494
Loans and advances to customers	440,722	500,135	515,606
Debt securities subject to repurchase agreements	55,554	91,173	79,480
Other debt securities	58,045	66,265	129,600
Debt securities	113,599	157,438	209,080
Equity shares	8,811	15,232	15,183
Settlement balances	5,591	5,741	7,771
Derivatives	288,039	441,903	529,618
Intangible assets	12,368	13,545	14,858
Property, plant and equipment	7,909	9,784	11,868
Deferred tax	3,478	3,443	3,878
Prepayments, accrued income and other assets	7,614	7,820	10,976
Assets of disposal groups	3,017	14,013	25,450
Total assets	1,027,878	1,312,295	1,506,867
Liabilities			
Bank deposits	35,329	57,073	69,113
Repurchase agreements and stock lending	28,650	44,332	39,691
Deposits by banks	63,979	101,405	108,804
Customers deposits	414,396	433,239	414,143
Repurchase agreements and stock lending	56,484	88,040	88,812
Customer accounts	470,880	521,279	502,955
Debt securities in issue	67,819	94,592	162,621
Settlement balances	5,313	5,878	7,477
Short positions	28,022	27,591	41,039
Derivatives	285,526	434,333	523,983
Accruals, deferred income and other liabilities	16,017	14,801	23,204
Retirement benefit liabilities	3,210	3,884	2,239
Deferred tax	507	1,141	1,945
Insurance liabilities	—	—	6,233
Subordinated liabilities	24,012	26,773	26,319
Liabilities of disposal groups	3,378	10,170	23,995
Total liabilities	968,663	1,241,847	1,430,814
Non-controlling interests	473	1,770	686
Owners' equity	58,742	68,678	75,367
Total equity	59,215	70,448	76,053
Total liabilities and equity	1,027,878	1,312,295	1,506,867

*Restated - see page 105.

Business review
Commentary on consolidated balance sheet
2013 compared with 2012
Total assets of £1,027.9 billion at 31 December 2013 were down £284.4 billion, 22%, compared with 31 December 2012. This was driven by the downsizing of the Markets business, primarily reflected in decreases in loans to banks and customers, debt securities and derivatives balances, and a further decrease in loans and advances to banks and customers due to Non-Core disposals and run off.

Loans and advances to banks decreased by £9.9 billion, 15%, to £54.1 billion. Excluding reverse repurchase agreements and stock borrowing ('reverse repos'), down £8.3 billion, 24%, to £26.5 billion, bank placings declined £1.6 billion, 6%, to £27.6 billion.

Loans and advances to customers declined £59.4 billion, 12%, to £440.7 billion. Within this, reverse repurchase agreements were down £20.1 billion, 29%, to £49.9 billion. Customer lending decreased by £39.3 billion, 9%, to £390.8 billion, or £35.2 billion to £416.0 billion before impairments. This reflected reductions in Non-Core of £19.9 billion, along with declines in International Banking, £6.2 billion, UK Corporate, £4.5 billion, Markets, £4.3 billion, Ulster Bank, £1.9 billion, UK Retail, £0.4 billion, Wealth, £0.3 billion, and US Retail & Commercial, £0.2 billion which included the impact of £0.7 billion of customer loans being transferred to assets of disposal groups at 31 December 2013. These decreases were partially offset by the effect of exchange rate and other movements, £2.5 billion.

Debt securities were down £43.8 billion, 28%, to £113.6 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds.

Equity shares decreased by £6.4 billion, 42%, to £8.8 billion due to the targeted run-down of Markets' equities business.

Movements in the value of derivative assets, down £153.9 billion, 35%, to £288.0 billion, and liabilities, down £148.8 billion, 34% to £285.5 billion, primarily reflects upward shifts in major yield curves which resulted in significant mark-to-market decreases on interest rate contracts.

Property, plant and equipment decreased by £1.9 billion, 19%, to £7.9 billion driven largely by the disposal of Non-Core assets.

Intangible assets decreased by £1.2 billion, 9%, to £12.4 billion primarily as a result of the write-down of goodwill relating to the International Banking division at 31 December 2013.

The decrease in assets and liabilities of disposal groups, down £11.0 billion, 78%, to £3.0 billion, and £6.8 billion, 67%, to £3.4 billion respectively, primarily reflects the deconsolidation of Direct Line Group following the further sale of shares and ceding of control in 2013. The remaining interest, classified as an associate, is included in assets of disposal groups at 31 December 2013. In addition, disposal groups include loans and deposits in Illinois branches for sale in US Retail & Commercial.

Deposits by banks decreased £37.4 billion, 37%, to £64.0 billion, with decreases in inter-bank deposits, down £21.7 billion, 38%, to £35.3 billion and repurchase agreements and stock lending ('repos'), down £15.7 billion, 35%, to £28.7 billion, as a result of the Group's lower funding requirements and reduced derivative cash collateral.

Customer accounts decreased £50.4 billion, 10%, to £470.9 billion. Within this, repos decreased £31.6 billion, 36%, to £56.5 billion. Excluding repos, customer deposits were down £18.8 billion, 4%, at £414.4 billion, primarily reflecting decreases in International Banking, £6.9 billion, Markets, £4.8 billion, UK Corporate, £2.4 billion, Wealth, £1.7

billion, Ulster Bank, £0.7 billion, US Retail & Commercial, £5.9 billion, which included the impact of £3.2 billion of customer deposits being transferred to liabilities of disposal groups at 31 December 2013, and the effect of exchange rate and other movements of £3.4 billion. These decreases were partially offset by increases in UK Retail, £7.3 billion.

Debt securities in issue decreased £26.8 billion, 28%, to £67.8 billion due to lower funding requirements as a result of the reduction in the overall size of the balance sheet, with most of the reduction in medium term notes in issue.

Retirement benefit liabilities decreased by £0.7 billion, 17%, to £3.2 billion with net actuarial gains of £0.5 billion arising from improved asset returns and higher discount rates partly offset by an increase in the assumed inflation rate. Additional employer contributions of £0.4 billion to the Group's Main scheme also reduced retirement benefit liabilities.

Subordinated liabilities decreased by £2.8 billion, 10% to £24.0 billion, primarily as a result of the net decrease in dated loan capital with redemptions of £3.4 billion and the effects of exchange and other movements of £1.2 billion being partially offset by issuances of £1.8 billion.

Minority interests decreased by £1.3 billion, 73%, to £0.5 billion, predominantly due to the deconsolidation of Direct Line Group following the further sale of shares and ceding of control in 2013.

Owner's equity decreased by £9.9 billion, 14%, to £58.7 billion, driven by the £9.0 billion attributable loss for the year together with movements in cash flow hedging reserves, £1.7 billion and foreign exchange reserves, £0.2 billion. Partially offsetting these reductions were share issuances of £0.4 billion, the termination of the contingent capital facility, £0.3 billion, the recognition of actuarial gains in respect of the Group's defined benefit pension schemes, net of tax, £0.2 billion and other reserve movements, £0.1 billion.

Business review

Commentary on consolidated balance sheet continued

2012 compared with 2011

Total assets of £1,312.3 billion at 31 December 2012 were down £194.6 billion, 13%, compared with 31 December 2011. This was principally driven by a decrease in loans and advances to banks and customers led by Non-Core disposals and run off, decreases in debt securities and the continuing reduction in the mark-to-market value of derivatives.

Loans and advances to banks decreased by £19.4 billion, 23%, to £64.0 billion. Excluding reverse repurchase agreements and stock borrowing (‘reverse repos’), down £4.7 billion, 12%, to £34.8 billion, bank placings declined £14.7 billion, 34%, to £29.2 billion.

Loans and advances to customers declined £15.5 billion, 3%, to £500.1 billion. Within this, reverse repurchase agreements were up £8.6 billion, 14%, to £70.0 billion. Customer lending decreased by £24.0 billion, 5%, to £430.1 billion, or £22.6 billion to £451.2 billion before impairments. This reflected reductions in Non-Core of £22.6 billion, along with declines in International Banking, £14.3 billion, UK Corporate, £2.9 billion, Markets, £1.0 billion and Ulster Bank, £0.7 billion, together with the effect of exchange rate and other movements, £4.7 billion. These were partially offset by the transfer from disposal groups of £18.9 billion of customer balances relating to the UK branch-based businesses, together with underlying growth in UK Retail, £2.6 billion, US Retail & Commercial, £1.9 billion and Wealth, £0.2 billion.

Debt securities were down £51.6 billion, 25%, to £157.4 billion, driven mainly by reductions within Markets and Group Treasury in holdings of UK and Eurozone government securities and financial institution bonds.

Settlement balance assets and liabilities decreased £2.0 billion to £5.7 billion and £1.6 billion to £5.9 billion respectively reflecting the overall reduction in the size of the balance sheet.

Movements in the value of derivative assets, down £87.7 billion, 17%, to £441.9 billion, and liabilities, down £89.7 billion, 17%, to £434.3 billion, primarily reflect decreases in interest rate and credit derivative contracts, together with the effect of currency movements, with Sterling strengthening against both the US dollar and the Euro.

Intangible assets decreased £1.3 billion, 9%, to £13.5 billion, primarily as a result of write-down of the Direct Line Group goodwill, £0.4 billion, and the transfer of the remaining £0.5 billion of goodwill together with £0.2 billion of other intangible assets to assets of disposal groups at 31 December 2012.

Property, plant and equipment decreased by £2.1 billion, 18%, to £9.8 billion driven largely by the disposal of investment property in Non-Core.

The decrease in assets and liabilities of disposal groups, down £11.4 billion, 45%, to £14.0 billion, and £13.8 billion, 58%, to £10.2 billion respectively, primarily reflects the removal of the UK branch-based businesses from disposal groups following Santander’s withdrawal from the purchase, together with the disposal of RBS Aviation Capital in the second quarter. These were partly offset by the transfer to disposal groups of Direct Line Group at 31 December 2012.

Deposits by banks decreased £7.4 billion, 7%, to £101.4 billion, with a decrease in inter-bank deposits, down £12.0 billion, 17%, to £57.1 billion. This was partly offset by an increase in repurchase agreements and stock lending (‘repos’), up £4.6 billion, 12%, to £44.3 billion, improving the Group’s mix of secured and unsecured funding.

Customer accounts increased £18.3 billion, 4%, to £521.3 billion. Within this, repos decreased £0.8 billion, 1%, to £88.0 billion. Excluding repos, customer deposits were up £19.1 billion, 5%, at £433.2 billion, primarily reflecting the transfer from disposal groups of £21.5 billion of customer accounts relating to the UK branch-based businesses together with underlying increases in UK Retail, £6.0 billion, International Banking, £2.0 million, US Retail & Commercial, £1.8 billion, UK Corporate, £0.8 billion, Ulster Bank, £0.7 billion and Wealth, £0.7 billion. This was partially offset by decreases in Markets, £9.7 billion, and Non-Core, £0.9 billion, together with exchange and other movements £3.8 billion.

Debt securities in issue decreased £68.0 billion, 42%, to £94.6 billion reflecting the maturity of the remaining notes issued under the UK Government’s Credit Guarantee Scheme, £21.3 billion, the repurchase of bonds and medium term notes as a result of the liability management exercise completed in September 2012, £4.4 billion, and the continuing reduction of commercial paper and medium term notes in issue in line with the Group’s strategy.

Short positions were down £13.4 billion, 33%, to £27.6 billion mirroring decreases in debt securities.

Retirement benefit liabilities increased by £1.6 billion, 73%, to £3.9 billion with net actuarial losses of £2.3 billion on the Group's defined benefit pension schemes, primarily arising from significant reductions in the real discount rates in the Sterling, Euro and US dollar currency zones. These were partially offset by the £0.6 billion excess of employer contributions paid over the current year pension charge.

Insurance liabilities of £6.2 billion relating to Direct Line Group were transferred to liabilities of disposal groups at 31 December 2012.

Subordinated liabilities increased by £0.5 billion, 2% to £26.8 billion, primarily as a result of the net increase in dated loan capital. Issuances of £1.4 billion and redemptions of £0.3 billion were partly offset by a net decrease of £0.6 billion arising from the liability management exercise completed in March 2012, which consisted of redemptions of £3.4 billion offset by the issuance of £2.8 billion new loan capital.

Non-controlling interests increased by £1.1 billion, 158%, to £1.8 billion, predominantly due to the sale of 34.7% of the Group’s investment in Direct Line Group during the fourth quarter.

Owner’s equity decreased by £6.7 billion, 9%, to £68.7 billion, driven by the £6.1 billion attributable loss for the period together with movements in foreign exchange reserves, £0.9 billion, the recognition of actuarial losses in respect of the Group’s defined benefit pension schemes, net of tax, £1.8 billion, and other reserve movements of £0.2 billion. Partially offsetting these reductions were gains in available-for-sale reserves, £0.6 billion, and cash flow hedging reserves, £0.8 billion, share capital and reserve movements in respect of employee share schemes, £0.8 billion and other share issuances of £1.0 billion.

Cash flow	2013	2012*	2011*
	£m	£m	£m
Net cash flows from operating activities	(30,631)	(45,113)	3,325
Net cash flows from investing activities	21,183	27,175	14
Net cash flows from financing activities	(2,728)	2,017	(1,741)
Effects of exchange rate changes on cash and cash equivalents	512	(3,893)	(1,473)
Net (decrease)/increase in cash and cash equivalents	(11,664)	(19,814)	125

*Restated - see page 105.

2013
The major factors contributing to the net cash outflow from operating activities of £30,631 million were the decrease of £28,780 million in operating assets and liabilities, the net operating loss before tax of £8,066 million from continuing and discontinued operations, loans and advances written-off net of recoveries of £4,090 million and other provisions utilised of £2,066 million. These were partially offset by provisions for impairment losses of £8,432 million and other provisions charged net of releases £4,422 million.

Net cash inflows from investing activities of £21,183 million related to the net inflows from sales of securities of £19,211 million, the sale of property, plant and equipment of £1,448 million and net divestments of business interests and intangible assets of £1,150 million offset by net cash outflows from the purchase of property, plant and equipment of £626 million.

Net cash outflows from financing activities of £2,728 million relate primarily to the repayment of subordinated liabilities of £3,500 million and interest paid on subordinated liabilities of £958 million partly offset by the issue of subordinated liabilities of £1,796 million.

2012
The major factors contributing to the net cash outflow from operating activities of £45,113 million were the decrease of £48,736 million in operating assets and liabilities, the net operating loss before tax of £5,388 million from continuing and discontinued operations, loans and advances written off net of recoveries of £3,925 million and other non-cash items of £1,491 million. These were partially offset by the elimination of foreign exchange differences of £7,140 million, provisions for impairment losses of £5,283 million and depreciation and amortisation of £1,854 million.

Net cash inflows from investing activities of £27,175 million related to the net inflows from sales of securities of £26,092 million, the sale of property, plant and equipment of £2,215 million and divestments in business interests and intangible assets of £352 million offset by net cash outflows from the purchase of property, plant and equipment of £1,484 million.

Net cash inflows from financing activities of £2,017 million relate primarily to the issue of subordinated liabilities of £2,093 million and proceeds of non-controlling interests issued of £889 million partly offset by interest paid on subordinated liabilities of £746 million and dividends paid of £301 million.

2011
The major factors contributing to the net cash inflow from operating activities of £3,325 million were the elimination of foreign exchange differences of £2,702 million, depreciation and amortisation of £1,875 million and inflow from

other items of £3,106 million, partially offset by the net operating loss before tax of £914 million from continuing and discontinued operations and the decrease of £3,444 million in operating assets and liabilities.

Net cash inflows from investing activities of £14 million related to the net inflows from sales of securities of £3,074 million, and sale of property, plant and equipment of £1,840 million offset by net cash outflows from investments in business interests and intangible assets of £1,428 million and from the purchase of property, plant and equipment of £3,472 million.

Net cash outflows from financing activities of £1,741 million relate primarily to interest on subordinated liabilities of £714 million, repayment of subordinated liabilities of £627 million and redemption of non-controlling interests of £382 million.

Business review

Capital resources

The following table analyses the Group's regulatory capital resources on a fully consolidated basis at 31 December as monitored by the Prudential Regulation Authority (PRA) for regulatory purposes.

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Capital base					
Tier 1 capital	50,626	57,135	56,990	60,124	76,421
Tier 2 capital	13,305	12,152	8,546	9,897	15,389
	63,931	69,287	65,536	70,021	91,810
Less: supervisory deductions	(272)	(2,487)	(4,828)	(4,732)	(4,565)
Total regulatory capital	63,659	66,800	60,708	65,289	87,245
Risk-weighted assets					
Credit risk					
- non-counterparty	291,100	323,200	344,300	385,900	513,200
- counterparty	22,300	48,000	61,900	68,100	56,500
Market risk	30,300	42,600	64,000	80,000	65,000
Operational risk	41,800	45,800	37,900	37,100	33,900
	385,500	459,600	508,100	571,100	668,600
Asset Protection Scheme relief	—	—	(69,100)	(105,600)	(127,600)
	385,500	459,600	439,000	465,500	541,000
Risk asset ratios	%	%	%	%	%
Core Tier 1	10.9	10.3	10.6	10.7	11.0
Tier 1	13.1	12.4	13.0	12.9	14.1
Total	16.5	14.5	13.8	14.0	16.1

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the PRA. The PRA uses risk asset ratio (RAR) as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a Tier 1 component of not less than 4%. At 31 December 2013, the Group's total RAR was 16.5% (2012 - 14.5%) and the Tier 1 RAR was 13.1% (2012 -12.4%). For further information refer to Risk and Balance sheet management: Capital management on pages 187 to 203.

Business review

Analysis of balance sheet pre and post disposal groups
In accordance with IFRS 5 assets and liabilities of disposal groups are presented as a single line on the face of the balance sheet. As allowed by IFRS, disposal groups are included within risk measures in the Risk and balance sheet management section.

	2013			2012			2011		
	Balance sheet £m	Disposal groups (1) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (2) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (3) £m	Gross of disposal groups £m
Assets									
Cash and balances at central banks	82,659	2	82,661	79,290	18	79,308	79,269	127	79,396
Net loans and advances to banks	27,555	22	27,577	29,168	2,112	31,280	43,870	87	43,957
Reverse repos	26,516	41	26,557	34,783	—	34,783	39,440	—	39,440
Loans and advances to banks	54,071	63	54,134	63,951	2,112	66,063	83,310	87	83,397
Net loans and advances to customers	390,825	1,765	392,590	430,088	1,863	431,951	454,112	19,405	473,517
Reverse repos	49,897	—	49,897	70,047	—	70,047	61,494	—	61,494
Loans and advances to customers	440,722	1,765	442,487	500,135	1,863	501,998	515,606	19,405	535,011
Debt securities	113,599	24	113,623	157,438	7,186	164,624	209,080	—	209,080
Equity shares	8,811	—	8,811	15,232	5	15,237	15,183	5	15,188
Settlement balances	5,591	—	5,591	5,741	—	5,741	7,771	14	7,785
Derivatives	288,039	1	288,040	441,903	15	441,918	529,618	439	530,057
Intangible assets	12,368	30	12,398	13,545	750	14,295	14,858	15	14,873
Property, plant and equipment	7,909	32	7,941	9,784	223	10,007	11,868	4,749	16,617
Deferred tax	3,478	1	3,479	3,443	—	3,443	3,878	—	3,878
Other financial assets	—	—	—	—	924	924	1,309	—	1,309
Prepayments, accrued income and other assets	7,614	936	8,550	7,820	742	8,562	9,667	456	10,123
Assets of disposal groups	3,017	(2,854)	163	14,013	(13,838)	175	25,450	(25,297)	153
Total assets	1,027,878	—	1,027,878	1,312,295	—	1,312,295	1,506,867	—	1,506,867
Liabilities									
Bank deposits	35,329	—	35,329	57,073	1	57,074	69,113	1	69,114
Repos	28,650	—	28,650	44,332	—	44,332	39,691	—	39,691

Deposits by banks	63,979	—	63,979	101,405	1	101,406	108,804	1	108,805
Customer deposits	414,396	3,273	417,669	433,239	753	433,992	414,143	22,610	436,753
Repos	56,484	—	56,484	88,040	—	88,040	88,812	—	88,812
Customer accounts	470,880	3,273	474,153	521,279	753	522,032	502,955	22,610	525,565
Debt securities in issue	67,819	—	67,819	94,592	—	94,592	162,621	—	162,621
Settlement balances	5,313	—	5,313	5,878	—	5,878	7,477	8	7,485
Short positions	28,022	—	28,022	27,591	—	27,591	41,039	—	41,039
Derivatives	285,526	1	285,527	434,333	7	434,340	523,983	126	524,109
Accruals, deferred income and other liabilities	16,017	101	16,118	14,801	2,679	17,480	23,204	1,233	24,437
Retirement benefit liabilities	3,210	1	3,211	3,884	—	3,884	2,239	—	2,239
Deferred tax	507	—	507	1,141	—	1,141	1,945	—	1,945
Insurance liabilities	—	—	—	—	6,193	6,193	6,233	—	6,233
Subordinated liabilities	24,012	—	24,012	26,773	529	27,302	26,319	—	26,319
Liabilities of disposal groups	3,378	(3,376)	2	10,170	(10,162)	8	23,995	(23,978)	17
Total liabilities	968,663	—	968,663	1,241,847	—	1,241,847	1,430,814	—	1,430,814

For the notes to this table refer to the following page.

Business review

Analysis of balance sheet pre and post disposal groups continued

	2013			2012			2011		
	Balance sheet £m	Disposal groups (1) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (2) £m	Gross of disposal groups £m	Balance sheet £m	Disposal groups (3) £m	Gross of disposal groups £m
Selected financial data									
Gross loans and advances to customers	415,978	1,774	417,752	451,224	1,875	453,099	473,872	20,196	494,068
Customer loan impairment provisions	(25,153)	(9)	(25,162)	(21,136)	(12)	(21,148)	(19,760)	(791)	(20,551)
Net loans and advances to customers (4)	390,825	1,765	392,590	430,088	1,863	431,951	454,112	19,405	473,517
Gross loans and advances to banks	27,618	22	27,640	29,282	2,112	31,394	43,993	87	44,080
Bank loan impairment provisions	(63)	—	(63)	(114)	—	(114)	(123)	—	(123)
Net loans and advances to banks (4)	27,555	22	27,577	29,168	2,112	31,280	43,870	87	43,957
Total loan impairment provisions	(25,216)	(9)	(25,225)	(21,250)	(12)	(21,262)	(19,883)	(791)	(20,674)
Customer REIL	39,322	—	39,322	40,993	13	41,006	40,708	1,549	42,257
Bank REIL	70	—	70	134	—	134	137	—	137
REIL	39,392	—	39,392	41,127	13	41,140	40,845	1,549	42,394
Gross unrealised gains on debt securities	1,541	—	1,541	3,946	230	4,176	4,978	—	4,978
Gross unrealised losses on debt securities	(887)	—	(887)	(1,832)	(15)	(1,847)	(3,408)	—	(3,408)

Notes:

(1) Primarily investment in associate (Direct Line Group) and Illinois branches of RBS Citizens.

(2) Primarily Direct Line Group.

(3) Primarily UK branch-based businesses, RBS Aviation Capital which was sold in 2012, and the remainder of RBS Sempra Commodities JV.

(4) Excludes reverse repos.

Risk and balance sheet management

Risk governance

Presentation of information
Except as otherwise indicated by an asterisk (*), information in the Risk and balance sheet management section (pages 169 to 359) is within the scope of the Independent auditor's report. Disclosures in this section include disposal groups in relevant exposures unless otherwise indicated. Refer to pages 167 and 168 for the Analysis of balance sheet pre and post disposal groups.

Risk governance*
Governance structure
The Group is committed to achieving the highest standards of corporate governance in every aspect of the business, including risk management.

A key aspect of the Group Board's responsibility as the main decision-making body at Group level is the setting of Group risk appetite to ensure that the levels of risk the Group is willing to accept in the attainment of its strategic business and financial objectives are clearly understood.

The day-to-day management of risk in the Group is carried out through two independent risk management functions: RBS Risk Management and Group Conduct and Regulatory Affairs, which manage risk through independent oversight and challenge of both the customer-facing businesses and the support functions. These risk management functions provide an overarching risk control framework linked to the risk appetite of the Group. For further detail on risk appetite, refer to page 178.

To enable the Group Board to carry out its objectives, it delegates authority to various committees as required and appropriate. A number of key committees specifically consider risk across the Group:

Group Board - Sets and owns the Group's risk appetite, which is cascaded across its divisions, functions and material legal entities. The Group Board also sets the Group's strategic direction and carries out regular assessments to ensure that strategic plans are consistent with risk appetite.

Board Risk Committee - Provides oversight and advice on current and potential risk exposures, risk strategy and tolerance. The Committee also promotes a risk awareness culture within the Group.

Group Executive Committee - Operates under delegated authority from the Group Board and considers emerging issues material to both the Group's strategy and risk exposures. The Group Executive Committee also oversees control frameworks.

Executive Risk Forum - Provides executive input to the Group Board and the Group Executive Committee on risk management issues such as risk appetite, risk policies and risk management strategies. It has full authority to act on all material and/or enterprise-wide risk and control matters across the Group and implements Group Board and Group Executive Committee risk management decisions.

Group Audit Committee - Reviews accounting policies, financial reporting and regulatory compliance practices of the Group, as well as its systems and standards of internal controls. It monitors the Group's processes for internal audit and external audit and relationships with regulatory authorities. It operates under delegated authority from the Group Board.

Group Risk Committee - Oversees and acts on material and enterprise-wide risk and control matters across the Group. It reviews and challenges risks and limits across the functional areas. It reviews risks and issues on both a thematic and specific basis, focusing on forward-looking, emerging risks. It considers the overall risk profile across the Group and identifies any key issues for escalation to the Executive Risk Forum. It operates under delegated authority from the Executive Risk Forum.

In addition, functional risk committees ensure that effective risk control frameworks are in place and that limits are consistent with the Group's risk appetite. Divisional executive committees develop, own and manage divisional risk appetites, ensuring that these are consistent with the Group's targets.

Risk management

The Group Chief Risk Officer leads RBS Risk Management through the strategic setting and execution of its responsibilities. The Group Chief Risk Officer reports directly to the Group Chief Executive and the Board Risk Committee, with a right of access to the Chairman of the Board Risk Committee.

RBS Risk Management is designed to align as closely as possible with the customer-facing businesses and support functions while maintaining an appropriate level of independence. This underpins the Group's approach to risk management and is reinforced through the Group by reporting lines from divisions to RBS Risk Management and from RBS Risk Management to senior executives, Boards and Committees.

In RBS Risk Management, the following Group risk functional heads report directly to the Group Chief Risk Officer and are responsible for Group-wide risk appetite and standards under their respective disciplines:

- Group Head of Operational Risk;
- Group Chief Credit Officer;
- Head of Enterprise Risk Management;
- Head of Global Country Risk; and
- Chief Operating Officer, RBS Risk Management.

Risk management in divisions focuses on all material risks including credit, market, operational, regulatory, country and business risk (refer to pages 183 to 186 for further detail of these risks). Liquidity risk and the day-to-day management of liquidity and funding of the Group's assets is Group Treasury's responsibility (refer to page 205). Oversight of risk in divisions is the responsibility of the relevant divisional Chief Risk Officer (CRO), with input from the relevant Group risk function heads.

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Risk governance* continued
Risk management continued
This involves ensuring:

- All activities undertaken by the individual divisions are consistent with the Group's risk appetite targets;

- Group policies and resulting operating frameworks, including delegated authorities and limits, are complied with through effective monitoring and exception reporting; and

- Operation of Group-wide risk processes such as the Group Policy Framework and the New Product Risk Assessment Process are effective.

Divisional CROs report directly to the Group Chief Risk Officer.

The Group Chief Risk Officer has direct involvement in the selection, appointment or removal of divisional CROs and Group risk function heads and also has responsibility for their ongoing performance assessment and management.

Divisions mirror the Group risk management structure: divisional executive committees are responsible for setting and managing their exposures in line with their risk appetite and within Group constraints. The divisional risk committees oversee risk exposures arising from divisional business activities and focus on ensuring that the associated risks are adequately monitored and controlled. The divisional CROs provide independent oversight of this process, with support from the Group Chief Risk Officer and Group risk function heads as appropriate. Additional challenge and oversight is provided by Group risk function heads on an ongoing basis and by divisional risk and audit committees on a periodic review basis. For a summary of the main risk types faced by the Group and how it manages each of them, refer to pages 182 to 186.

Conduct and Regulatory Affairs
Created in August 2013, by amalgamating Group Compliance (previously part of RBS Risk Management) and RBS Regulatory Affairs (formerly part of RBS Legal), Group Conduct and Regulatory Affairs is led by the Group Head of Conduct and Regulatory Affairs, who reports directly to the Group Chief Executive and the Board Risk Committee, with right of access to the Chairman of the Board.

The following functional heads report directly to the Group Head of Conduct and Regulatory Affairs, each of whom is responsible for the firm-wide risk appetite and standards of their respective disciplines: the Global Head of Compliance; the Global Head of Financial Crime; and the Director, RBS Regulatory Affairs.

A Chief Compliance Officer in each division (reporting to the Global Head of Compliance) provides advisory support to assist the divisions' management of conduct, regulatory affairs and financial crime.

Three lines of defence
The three lines of defence is an industry-wide model for the management of risk, understood as a clear set of principles by which to implement a cohesive operating model across an organisation. The model's main purpose is to define accountabilities and responsibilities for managing risk across the organisation.

1st line of defence - Business units including all business areas and functions are accountable for owning and managing the risks which exist in their area within a defined risk appetite and framework.

2nd line of defence - Independent monitoring and control functions, as well as Group Policy Standard owners, are accountable for owning and developing the risk and control frameworks and tools which the 1st line of defence uses to discharge its responsibilities. The 2nd line of defence must be appropriately independent from the business and accountable for overseeing and challenging the 1st line of defence on the effective management of its risks.

3rd line of defence - Group Internal Audit provides independent assurance on the appropriateness of the design and operational effectiveness of risk management and internal control processes that mitigate the Group's key risks.

Business model

The Group is a bank serving approximately 24 million retail and corporate customers worldwide. UK Retail offers individuals a wide range of traditional retail banking and insurance products, including residential mortgages and credit cards, while UK Corporate provides both small businesses and large corporations with an extensive range of loan products and transactional services. Most of the customers of both divisions are located in the UK. Wealth provides both banking and investment services to high-net-worth individuals in the UK and overseas, while International Banking offers loan products and transactional services to corporations and financial institutions across a wide range of countries. Markets provides corporations and financial institutions in both the UK and overseas with investment banking products and services, helping them to hedge exposures to interest rate and foreign exchange risk. Markets also helps customers structure securitisation transactions and issue debt.

In addition, Ulster Bank and Citizens Bank, offer loan and investment products, as well as transactional services, to individuals and corporations. The customers of Ulster Bank are in Ireland while those of Citizens Bank are in the US. The Group delivers its products through a diverse array of channels, including extensive branch networks, in-store branches and call centres, in addition to online and mobile channels.

It is the aim of the Group to become a bank that customers, and all other stakeholders, can depend on. It intends to do so by focusing on its core retail and corporate customers in its main market of the UK. It plans to simplify its products and services as well as the processes it uses to deliver them, enhancing their appeal. Simplifying processes should also lower costs, enabling the bank to provide customers with better products and services at lower prices.

The Group's main sources of earnings are interest income from lending and deposits and fee income from transactional and other services. Given the low interest rate environment in both the UK and the US, its net interest margin, that is, the difference between the interest it earns from lending and the interest it pays on deposits, has been under pressure. In order to offset this pressure, the Group is working to reduce costs and increase non-interest income.

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Business review Risk and balance sheet management

Risk governance* continued
Business model continued
Over the last few years, the Group has either exited or sold a number of businesses in order to align its cost structure with its smaller scope and scale. In addition, it is reducing costs through rationalisation, integration and simplification. For example, UK Retail is rationalising its service delivery channels and simplifying the operations that support them, using the resulting cost savings to invest in new technology and providing additional channels for customers such as mobile banking. A number of other divisions are taking similar steps.

The Group's activities expose it to a number of risks. The Group is pursuing a strategy of reducing the risks it takes while focusing on the delivery of products and services to a domestic customer base, giving rise to strategic risk. The delivery of all of its products and services exposes the Group to conduct risk, which has recently materialised in the form of fines and reputational damage, resulting from a failure to treat customers in line with their and other stakeholders' expectations.

The Group also faces a range of other risks. As measured by risk-weighted assets (RWAs), the most significant of these is credit risk, which consists of counterparty and non-counterparty credit risk. Credit risk arises from its lending activities in all divisions. Counterparty credit risk arises from its security financing and derivative trading activities. This is concentrated in Markets.

RWAs by division

The second most significant source of risk is market risk, which arises from the Group's trading activities (traded market risk) and from the impact of changes in market prices on the value of its other financial assets and liabilities (non-traded market risk). Traded market risk is concentrated in Markets while non-traded market risk is distributed across the Group and with the exception of US Retail & Commercial and Markets, these divisions transfer this risk to Group Treasury for management.

Operational risk, which arises from all of the Group's business activities, is the third most significant source of risk as measured by RWAs. Its importance is increasing as a result of changes driven by regulation as well as the Group's strategy.

The activities of several divisions, particularly Markets and International Banking, but also Ulster Bank and US Retail & Commercial, expose the Group to country risk.

Finally, through the activities of all its divisions, the Group is exposed to a range of other risks, including pension, business, regulatory and reputational.

Risk events and lessons learned
LIBOR related settlements
The Group reached settlements with the Financial Services Authority (FSA) in the United Kingdom, the United States Commodity Futures Trading Commission (CFTC) and the United States Department of Justice (DOJ) on 8 February 2013 in relation to investigations into submissions, communications and procedures around the setting of the London Interbank Offered Rate (LIBOR). The Group agreed to pay penalties of £87.5 million, $325 million and $150 million to the FSA, CFTC and DOJ respectively. As part of the settlement with the DOJ, RBS plc entered into a Deferred Prosecution Agreement on one count of wire fraud relating to Swiss Franc LIBOR, and one count for an anti-trust violation relating to Yen LIBOR. RBS Securities Japan Limited also agreed to enter a plea of guilty to one count of

wire fraud relating to Yen LIBOR.

Industry-wide investigations were made into the setting of certain benchmark rates across a range of currencies. Regulators found wrongdoing on the part of 21 RBS employees, predominantly in the setting of the bank's Yen and Swiss Franc LIBOR submissions.

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Risk governance* continued

Risk events and lessons learned continued

Both before and after these findings were issued, management took action to strengthen significantly the systems and controls governing its LIBOR submissions: the Group created an independent and ring-fenced rate-setting team; all relevant staff were obliged to undertake a comprehensive training programme; and new preventative and detective controls put in place, including monitoring and statistical checking of submissions by independent personnel in the Group. A rate setting review board was also created to oversee the submission process.

For more information on LIBOR related settlements, refer to page 467.

Payment Protection Insurance

Since the judicial review decision in 2011, the Group has worked closely with both the Financial Conduct Authority and the Financial Ombudsman Service. It has invested considerable resources in ensuring that all Payment Protection Insurance (PPI) complaints are handled in a fair manner in line with regulatory requirements. The Group stopped selling PPI in 2010 and has since then made a number of changes to ensure fair customer outcomes and to ensure that the appropriate lessons are learned from PPI. These include substantially simplifying our retail product offering and sales processes (including, but not limited to, protection products), enhancing training for, and controls in relation to, customer advisers and improving management information on products sales. Our product design and approval processes are now also radically different from the time when PPI products were available to customers.

UK Retail and the wider Group are engaged in a wide-ranging conduct risk programme designed to ensure the focus of our culture is always on the customer and delivering good customer outcomes. While this is a long-term project, the Group is confident that it has already resulted in material changes to the way it conducts business.

For more information on PPI refer to page 471. For information on other litigation, investigations and reviews, refer to pages 466 to 474.

Top and emerging risk scenarios

As part of its risk management process, the Group identifies and monitors its top and emerging risk scenarios. These are events that, should they materialise, would lead to a significant unexpected negative outcome, thereby causing the Group as a whole, or a particular division, to fail to meet one or more strategic objectives. In assessing the potential impact of risk materialisation, the Group takes into account both financial and reputational considerations.

Management is concerned with a range of risk scenarios. However, a small number attracted particular attention from senior management during the past year. These were grouped into four broad categories:

- Macroeconomic risks;
- Conduct, regulatory and legal risks;
- Risks related to the Group’s operations; and
- Political risk.

Further information on these and other risks facing the Group is detailed in Risk factors on pages 513 to 526.

The Group’s top and emerging risks are as follows:

Macroeconomic risks

(i) Increased impairments arising from defaults in sectors to which the Group has concentrated exposures, particularly commercial real estate and shipping
The Group has material exposure to borrowers in a number of sectors, particularly shipping. This sector has experienced falling revenues and declining asset values. If global economic growth remains subdued, losses in these sectors may increase unexpectedly. Any such losses may be exacerbated by issues related to controls.

Impact on the Group
If borrowers default, the value of the Group's collateral may prove inadequate to repay the associated debt, leading to increased impairments. UK Corporate is likely to be most affected.

Mitigants
Optimisation of the Group's shipping and a significant proportion of commercial real estate portfolios is part of Capital Resolution Group strategy.

(ii) Increased impairments arising from a more severe than expected economic downturn
The Group's return to profitability depends on the economic recovery of its major markets. If their recovery is slower than expected, the Group's return to profitability and private ownership may also be deferred. All divisions could be affected.

Impact on the Group
A slower than expected recovery would likely result in lower revenues and income, and higher impairments. It could also result in higher operational losses. If such a downturn were prolonged, capital might also be negatively affected.

Mitigants
The Group develops business plans to take into account the possibility of slow economic growth and implemented strategies, such as cost reductions, to reduce its vulnerability.

(iii) An increase in the Group's obligations to support pension schemes
The Group has established various pension schemes for its employees as a result of which it has incurred certain obligations as sponsor of these schemes. If economic growth stagnates and interest rates remain low as a result, the value of pension scheme assets may not be adequate to fund the pension schemes' liabilities. All of the Group's businesses are exposed to this risk.

Impact on the Group
As asset values were lower and liabilities higher when valued most recently, the Group may be required to set aside additional capital in support of the schemes. The amount of additional capital required depends on the size of the shortfall when the assets are valued as well as the efficacy, and acceptability to the regulator, of management actions undertaken to address it.

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Risk governance* continued

Top and emerging risk scenarios continued

In addition, the Group may be required to increase its cash contributions to the schemes. Similarly, the amount of additional cash contributions that may be required depends on the size of the shortfall when the assets are valued. If interest rates fall further, the value of the schemes' assets may decline while the value of their liabilities increases, leading to a need to increase cash contributions.

Mitigants

The trustee is responsible for the investment of the main scheme's assets, which are held separately from the assets of the Group.

Conduct, regulatory and legal risks

(i) Increased conduct costs and reputational damage arising from a failure to achieve fair customer outcomes.

In order to achieve its strategic objectives, the Group must put the customer at the heart of its business.

Impact on the Group

Failure to do so would cause the Group to fail to achieve its strategic objectives, which would affect earnings, liquidity, capital and shareholder confidence adversely. The risk of failure affects all divisions.

Mitigants

In order to address this risk, during the year the Group continued to embed good conduct at the heart of the business to ensure fair outcomes for customers.

(ii) Losses or reputational damage arising from litigation

Given its diverse operations, the Group is exposed to the risk of litigation. For example, during the course of 2013, it was subject to shareholder litigation, securities related litigation, various class actions claims, including those related to LIBOR and foreign exchange trading, and mass consumer claims such as those related to Payment Protection Insurance and interest rate hedging products. This risk affects all of the Group's divisions.

Impact on the Group

As a result of litigation, the Group may incur fines, be ordered to pay damages or other compensation, suffer reputational damage, or face limitations on its ability to operate. For example, in the case of LIBOR, the Group agreed to pay settlement penalties to resolve investigations by the European Commission into Yen LIBOR competition infringements and EURIBOR competition infringements.

Mitigants

The Group defends claims against it to the best of its ability and it co-operates fully with various governmental and regulatory authorities.

(iii) Increased costs arising from a failure to demonstrate compliance with existing regulatory requirements related to conduct, particularly with respect to mis-selling

The Group is subject to regulation governing the conduct of its business activities. For example, it must ensure that it sells its products and services only to informed customers. This affects all divisions.

Impact on the Group

If the Group sells products to uninformed customers, or fails to handle complaints well, it may be subject to fines, incur remediation costs or even be subject to criminal charges. It may also suffer significant damage to its reputation.

Mitigants
Although more work needs to be done to mitigate this risk, the Group has simplified some products and stopped offering others. Where appropriate, it has compensated purchasers of some products and services, such as payment protection insurance and certain interest rate hedging products. Future payments of such compensation would give rise to additional costs.

Risks related to the Group’s operations

(i) Increased losses arising from cyber attacks
The Group has experienced cyber attacks, which are increasing in frequency and severity across the industry. This risk affects all divisions.

Impact on the Group
A successful cyber attack could lead to fraudulent activity or the loss of customer data. The Group could experience significant losses as a result of the need to reimburse customers, pay fines or both. Furthermore, a successful cyber attack could cause significant damage to the Group’s reputation.

Mitigants
The Group has participated in an industry-wide cyber attack simulation. It has also initiated a large scale programme to improve controls over user access. In addition, it has reviewed its websites and taken steps to rationalise them, put additional anti-virus protections in place and taken steps to educate staff on information protection.

(ii) Increased losses arising from the failure of information technology systems
The Group’s information technology systems are vulnerable to failure. Because they are complex, recovering from failure is very challenging.

Impact on the Group
A failure of information technology systems could lead to the Group’s inability to process transactions or provide services to its customers. Should a failure not be rectified promptly, the Group might lose customers, be subject to fines, incur remediation costs or face legal action. Its reputation might also suffer.

Mitigants
The Group has launched a major investment programme to improve resilience, which has already had an impact. The Group has also enhanced its back up systems and created a ‘shadow bank’ capable of providing basic services in the event of need. Finally, the Group is improving the documentation of critical business functions.

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Risk governance* continued

Top and emerging risk scenarios continued

(iii) Increased costs arising from a failure to execute successfully major projects

The Group has a number of major projects underway, the successful conclusion of which is essential if it is to meet new regulatory and strategic requirements. These new requirements affect its organisational structure, its business strategies, its information technology systems, its operational processes and its product offerings. Given the number, scale and complexity of these projects, the Group may not complete them successfully, or at all. This affects all divisions.

Impact on the Group

If the Group does not complete these projects successfully, the interests of customers may be affected, necessitating customer redress. The Group may also incur regulatory fines, lose market share and suffer damage to its reputation.

Mitigants

The Group is working to implement change in line with its project plans while assessing the risks to implementation and taking steps to mitigate those risks where possible.

(iv) Increased costs due to an inability to recruit or retain suitable staff

The Group is undergoing significant organisational change, the result of a need to implement new business strategies and respond to a changing external environment. The pace of change, coupled with the associated uncertainty may cause experienced staff members to leave the Group and prospective staff members not to join. Although these risks concern all divisions, they particularly affect Markets and US Retail & Commercial.

Impact on the Group

If it cannot retain or attract the necessary staff members, the Group may be unable to implement its business strategies or meet regulatory requirements on time, or at all. It may also experience control failures. The Group's reputation may suffer as a result.

Mitigants

The Group has communicated expected changes in its organisational structure to members of staff, implementing plans aimed at minimising unexpected staff losses. The Group is also working to develop and implement an enhanced recruitment strategy.

Political risks

The Group and the Royal Bank, its principal operating subsidiary, are both headquartered and incorporated in Scotland. The Scottish Government is holding a referendum in September 2014 on the question of Scottish independence from the UK. Although the outcome of the referendum is uncertain, subject to any mitigating factors, the uncertainties resulting from an affirmative vote in favour of independence would be likely to significantly impact the Group's credit ratings and could also impact the fiscal, monetary, legal and regulatory landscape to which the Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the European Union.

The occurrence of any of the impacts above could significantly impact the Group's costs and would have a material adverse effect on the Group's business, financial condition, results of operations, and prospects.

Stress testing

Governance

Stress testing is the evaluation of a bank’s financial position under severe but plausible stress scenarios. Stress testing also refers to the broader framework under which these tests are developed, evaluated and used within the Group’s decision-making process in the context of the wider economic environment.

The Group’s stress testing framework is designed to embed stress testing as a key risk management technique into mainstream risk reporting, capital planning and business processes at divisional, legal entity and Group levels.

The Executive Risk Forum (refer to Risk governance on page 171 for further information) is the main body overseeing the Group's stress testing approach, processes and results. The forum is primarily responsible for reviewing and challenging the results of any Group-wide stress test and ensuring that, where necessary, appropriate management actions are undertaken.

The Board Risk Committee receives reports detailing stress tests undertaken as part of the financial planning process. It reviews and challenges the stress scenarios and considers their impact on the Group's financial position. These reports outline relevant management actions as well as the extent to which such actions mitigate the effects of the stress scenario on the Group’s capital adequacy.

The Board Risk Committee may also request additional stress tests as it deems necessary. Stress testing forms part of the Group's risk and capital management framework and is a major component of the Basel III requirements. It highlights to senior management potential unexpected adverse 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.

Scenario selection

Stress test scenarios target both firm-wide vulnerabilities and negative global impacts. They consider a five year horizon and include stress projections for macroeconomic variables such as gross domestic product, unemployment rates, property prices, stock price indices, interest rates and inflation. The tests include a variety of scenarios, including some featuring an intensification of the eurozone’s sovereign debt problems.

Under one of them, there is a severe recession in the UK in 2013/2014, a sharp rise in unemployment and a marked fall in equity prices. There are downgrades of UK sovereign debt by two notches, and corresponding downgrades for UK banks, including the Group, leading to increased funding costs and lower levels of lending. As the economic environment deteriorates, there is market concern about losses in the banking sector.

Another test run in 2013 is a high inflation-no growth scenario. Inflationary pressures surge as a result of the growth in central bank balance sheets in recent years. Sovereign bond yields rise steeply as market sentiment sours, and there is a reduction in disposable income and corporate profits, leading to a global recession. Recovery begins only in late 2014. As the bank’s risk profile improves as a result of deleveraging, it should be better able to withstand extreme stress scenarios.

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Risk governance* continued
Stress testing continued
Methodologies
Stress testing is part of the financial planning process and is conducted and presented to senior management semi-annually. Once simply conducted principally to meet regulatory requirements, it is now an integral part of enterprise risk management and used to assess the impact of business decisions on the Group's capital position.

As part of the financial planning and strategy cycle, stress tests are conducted by divisions and aggregated to produce firm-wide results. These stress tests are also used for monitoring divisional and Group risk appetite.

Risk-type specific stress testing is also conducted. For example, within the market risk management framework, a comprehensive programme of stress tests covers a variety of historical and hypothetical scenarios. Reverse stress testing, explicitly identifying and assessing scenarios most likely to render the bank's business model unviable, is also conducted as required by the PRA. In order to cross the business model failure threshold, an instantaneous one year global shock of a similar scale as the 2008 financial crisis is required, but the impact of such a scenario is more likely to be felt over multiple years. Future revenues, and the gradual disposal of Non-Core assets, would partially offset losses, making failure much less likely.

Portfolios subject to review
Portfolio specific stress tests assess the reaction of key-focus portfolios to systemic shocks and individual risk factors to identify potential vulnerabilities, including risks that have not yet matured or are not yet visible. They assess the potential for outsized losses and the impact of rebalancing portfolios.

External stress tests
The Group also takes part in a number of external stress tests. In 2014 the Group will take part in the Bank of England's concurrent stress test of the UK banking system, as well as an industry-wide external stress test conducted by the European Banking Authority on the European Union banking system.

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Risk appetite

Risk appetite*

Risk appetite is both a key business tool and an integral part of the Group's enterprise-wide approach to risk management. It is aligned with the Group's strategic objectives, aiming to strike an optimal balance between building a sustainable risk profile and creating long-term value for the Group's customers, investors and wider stakeholders. The risk appetite framework seeks to ensure that each business can withstand significant deteriorations in economic and market conditions.

The Group's risk appetite is set and owned by the Group Board which identifies and establishes the level and types of risks the Group is able and willing to take in order to meet its:

- Strategic objectives - the Group's strategic plan is built on the core foundations of serving customers well, building a sustainable risk profile and creating long-term value for its shareholders; and

- Wider obligations to stakeholders - a bank that is safe and sound and puts serving customers at the heart of its thinking will also perform well for its owners, employees, regulators and communities.

Risk appetite is cascaded and embedded across the Group. The risk appetite framework provides each business with a greater understanding of acceptable risk levels, aligning commercial strategies with the most effective use of financial resources, such as capital, funding and risk capacity. Risk appetite provides a solid platform that allows the Group to focus on its key business strengths and competitive advantages over the long term.

The Board Risk Committee reviews the Group's risk appetite framework and targets on an annual basis to ensure they remain aligned with strategic objectives, business performance, emerging risks and changes in the external environment.

Strategic risk objectives

Risk management plays an integral role in the delivery of the Group's strategic goal. The implementation of a stronger and more effective culture of risk management and control provides the platform necessary to address vulnerabilities, rebuild on core strengths and position the Group on a sustainable and profitable path for future growth.

Financial strength and resilience are at the heart of the Group's strategic plan. The Group has defined this level of robustness as that which is capable of achieving and sustaining a standalone credit rating (i.e. without government support) that is in line with those of its strongest international peers.

Given this central aim, in 2009 the Group Board set out four key strategic objectives, aligned with the Group's strategic plan.

- Maintain capital adequacy. To ensure that the Group has sufficient capital resources to meet regulatory requirements and to cover the potential for unexpected losses in its asset portfolio.

- Deliver stable earnings growth. To ensure that strategic growth is based around a longer-term risk versus reward consideration, with significantly lower volatility in underlying profitability than was seen during the financial crisis.

- Ensure stable and efficient access to funding and liquidity. To ensure that the Group has sufficient funding to meet its obligations, taking account of the constraint that some forms of funding may not be available when they are most needed.

- Maintain stakeholder confidence. To ensure that stakeholders have confidence in the Group's recovery plan, its ability to deliver its strategic objectives and the effectiveness of its business culture and operational controls.

Each objective is essential in its own right, but also mutually supportive of the others. The strategic risk objectives are the bridge between the 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.

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Risk appetite* continued

Risk appetite measures

Risk appetite starts with the strategic goals and risk philosophy set by the Group Board and is cascaded through key targets, limits and risk tolerances that influence decision making, from the enterprise-wide to the transactional level.

The risk appetite framework is based on four main pillars:

- Risk envelope metrics - The Group has set sustainable business goals over a medium-term horizon, including a target for the capital ratio, leverage ratio, loan:deposit ratio, liquidity portfolio and use of wholesale funding. These are the broad boundaries within which the Group operates. Non-Core division also acts as a primary driver for reducing risk and the size of the balance sheet.

- Quantitative risk appetite targets - Risk appetite is also aligned with potential risk exposures and vulnerabilities under severe but plausible stress conditions. Quantitative targets, to be met under stress conditions, are set around the Group's strategic risk objectives for maintaining capital adequacy, delivering stable earnings growth and ensuring stable and efficient access to funding and liquidity.

- Qualitative risk appetite targets - The fourth strategic risk objective of maintaining stakeholder confidence covers qualitative aspects relating to the culture of risk management and controls and meeting stakeholder expectations. Risk appetite is based around identified expectations across a range of stakeholders (e.g. customers, employees, investors and the general public) and is closely aligned with key risk policies and controls (e.g. the Group Policy Framework, conduct risk and reputational risk).

- Risk control frameworks and limits - Risk control frameworks set detailed tolerances and limits for material risk types (e.g. credit risk, market risk, conduct risk and operational risk) that are used to manage risk on a day-to-day basis. These limits support and are required to be consistent with the high-level risk appetite targets.

The framework is supported by a programme of communication, engagement and training rolled out across the Group to embed a wide understanding of the purpose and value of an effective risk appetite.

Risk appetite supports value creation in a safe sustainable way. It is embedded within the annual planning and budgeting process. Business strategies are designed on the basis of key value drivers (e.g. customer franchises, income and profit generation, synergies) and whether they fit within agreed risk appetite boundaries. 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 - assesses how earnings, capital and funding positions change under an unfavourable, yet plausible, scenario. Stress scenarios can differ by theme, geographical location or severity.

- Economic capital - provides complementary insights, with a breadth of understanding of risk profile changes and 'tail risks' generated by stimulating millions of different scenarios.

- Sensitivity analysis - provides 'ready reckoners' around changes in key variables. It provides a high-level view on questions such as 'what if gross domestic product worsened by a further 1%', identifying certain tipping points where the Group's risk profile moves outside appetite.

More effective processes for reporting the results have also been developed, presenting the Board and senior management with a more holistic and dynamic view of key risk exposures.

Divisional risk appetite statements

Risk appetite is set at the Group level then cascaded and embedded across all business areas. Each division is required to develop, own and manage a risk appetite statement aligned with the Group's risk appetite and:

- Covers all identified material risks;
- Enables each business to understand its acceptable levels of risk; and
- Ensures that commercial strategies are aligned with the use of available financial resources.

By setting a clear risk appetite and embedding a strong risk culture throughout its businesses, the Group can identify, measure and control risk exposures and respond effectively to shocks. Each division is responsible for ensuring its strategic plans are consistent with its approved risk appetite.

Risk control frameworks and limits

Risk control frameworks and their associated limits are an integral part of the risk appetite framework and a key part of embedding risk appetite targets in day-to-day risk management decisions. The risk control frameworks manage risk concentrations on a 'bottom-up' basis through portfolio and product limit setting, expressing a clear tolerance for material risk types that is aligned to business activities. These are aligned with a 'top-down' approach via a calibration of their aggregate contribution with the Group's risk appetite targets (i.e. earnings volatility, capital and liquidity consumption and impact on stakeholder confidence).

The Group Policy Framework directly supports the qualitative aspects of risk appetite, helping to rebuild and maintain stakeholder confidence in the Group's risk control and governance. Its integrated approach is designed to ensure that an appropriate standard of control is set for each of the material risks the Group faces, with an effective assurance process put in place to monitor and report on performance. Risk appetite has its own policy standard within the Group Policy Framework that sets out clear roles and responsibilities to measure, cascade and report performance against risk appetite, as well as to provide assurances that business is being conducted within approved risk limits and tolerances.

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Risk appetite* continued

Culture, values and remuneration

Objectives for risk culture

Risk culture plays a key role in the Group's ambition to build "a really good bank". A strong risk culture is a key part of ensuring risk appetite is effectively embedded across the Group. The link between risk appetite and strategic objectives encourages people at all levels of the business to think about risk, how they identify it and how they manage it. It incorporates the quantitative and qualitative aspects of risk and uses both absolute and relative risk measures.

Risk culture policies

The Group's values - of "serving customers well", "working together", "doing the right thing" and "thinking long term" - act as a clear starting point for a strong and effective risk culture. A wide range of communication and engagement activities (detailed below) has been undertaken to discuss the meaning of each value with employees and how they affect and guide day-to-day activities.

The embedding of the Group's values into a strong risk culture is supported by a revised and more focused Code of Conduct. The Code provides guidance on expected behaviour and sets out the standards of conduct that support the Group's values. It explains the effect of decisions that are taken and describes the principles that must be followed.

These business principles cover conduct related issues as well as wider business activities. They focus on desired outcomes, with practical guidelines to align the Group's values with its commercial strategy and actions. The embedding of business principles facilitates sound decision making and a clear focus on good customer outcomes in 'the moments that matter'. It is aligned with the people management and remuneration processes to support a positive and strong risk culture through appropriate incentive structures.

Training

Across the risk management function, a series of events and activities have been undertaken to 'bring alive' the Group's values and culture for employees. This is supported by performance management processes that hold individuals to account for poor behaviour and reward the behaviour that supports our purpose, visions and values.

Challenge mechanisms

A simple decision making guide (called the "YES check") has been included within the Code of Conduct. It is a simple, intuitive set of five questions, designed to ensure the values guide day-to-day decisions:

- Does what I am doing keep our customers and the Bank safe and secure?
- Would customers and colleagues say I am acting with integrity?
- Am I happy with how this would be perceived on the outside?
- Is what I am doing meeting the standards of conduct required?
- In five years time would others see this as a good way to work?

Each question is a prompt to think about the situation and how it fits with the Group’s values. It ensures that employees can think through decisions that don’t have a clear answer, guiding the judgements behind their decisions and actions.

Risk-based key performance indicators
The Group’s policy standards require all current Code Staff roles to use a balanced scorecard approach to performance management. This ensures recognition of the longer-term business requirements and a balance between financial and non-financial metrics, including an evaluation of adherence to internal controls and risk management. Since 2011, all Code Staff roles have had specific risk objectives in their performance plan.

Unvested awards are subject to clawback and may be reduced, or forfeited in full, at the discretion of the Group Performance and Remuneration Committee. For Code Staff roles, the Committee can apply clawback if the company, business area and team, or the individual subsequently incurs significant loss (either financial or reputational), or if the Group as a whole suffers a material failure of risk management or material downturn in its financial performance.

Awards to employees under the Group's long-term incentive plan are subject to financial and operational measures and an underlying requirement for effective risk management during the performance period.

The Group Performance and Remuneration Committee has put in place a Group-wide remuneration policy which is explicitly aligned with effective risk management. Performance is a key input into the determining of remuneration levels. Group and divisional plans and targets are aligned with the risk appetite and the long-term interests of the Group, as determined by the Board. These targets are the basis of Group Executive members’ objectives, which are approved by the Group Performance and Remuneration Committee. These objectives are then cascaded through the divisions and functions.

There is significant focus on risk in performance assessment with all executives and Code Staff receiving specific risk feedback through an independent “360-degree” feedback process. As part of the line manager’s assessment of individual performance divisional control functions, including risk, provide independent input to the line manager.

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Risk appetite* continued

Risk coverage

The Group continued to strengthen its approach to risk management amid a challenging and ever-changing external environment in 2013. Areas of progress included:

- The completion of the phased roll-out of the Group's conduct risk policies and of a more effective operating model, supported by the development and delivery of awareness initiatives and targeted training;
- The implementation of the enhanced country risk appetite framework, including top-down risk appetite, and of enhanced assurance processes;
- The introduction of a new integrated operating model for managing regulatory developments, which combines divisional and functional teams to leverage expertise more effectively; and
- Further strengthening of the Group's credit risk management framework.

The main risk types faced by the Group are presented below, together with a summary of the key areas of focus and how the Group managed these risks in 2013. In preparing disclosures related to these risks, the Group has considered the recommendations of the Enhanced Disclosure Task Force issued in October 2012. A summary of the recommendations and list of disclosures that meet these recommendations has been included on page 557.

Risk type	Definition	Features	How the Group manages risk and the focus in 2013
Capital adequacy risk	The risk that the Group has insufficient capital.	Arises from: Inefficient management of capital resources. Character and impact: Characterised typically by credit risk losses. It has the potential to disrupt the business if there is insufficient capital to support business activities. It also has the potential to cause the Group to fail to meet regulatory requirements. Group capital and earnings may be affected, impairing the activities of all divisions.	The Group's Core Tier 1 ratio on a Basel 2.5 basis was 10.9% and on a fully loaded Basel III (FLB3) basis was 8.6% at 31 December 2013. The Group is targeting a FLB3 Common Equity Tier 1 ratio of c.11% by the end of 2015 and 12% or above by the end of 2016. The timely run-down of RCR and the successful divestment of Citizens are key to the achievement of the Group's capital plans. Refer to the Capital management section on pages 187 to 203 for further information.

Liquidity and funding risk	The risk that the Group is unable to meet its financial liabilities as they fall due.	Arises from: The Group's day-to-day operations. Character and impact: Dependent on company-specific factors such as maturity profile and composition of sources and uses of funding, the quality and size of the liquid asset buffer as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour. It has the potential to cause the Group to fail to meet regulatory liquidity requirements, become unable to support normal banking activity or at worst cease to be a going concern. Adverse impact on customer and investor confidence in the Group and the wider financial system is also possible.	Liquidity and funding metrics continued to strengthen with short-term wholesale funding of £32.4 billion, covered more than four times by a liquidity portfolio of £146.1 billion. Liquidity coverage and net stable funding ratios also improved. Refer to the Liquidity and funding risk section on pages 204 to 221 for further information.

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Risk appetite*: Risk coverage continued

Risk type	Definition	Features	How the Group manages risk and the focus in 2013
Credit risk	The risk of financial loss due to the failure of a customer, or counterparty, to meet its obligation to settle outstanding amounts.	Arises from: Deterioration of the credit quality of customers or counterparties of the Group, leaving them unable to meet their contractual obligations. Character and impact: Losses can vary materially across portfolios and may include the risk of loss due to the concentration of credit risk related to a specific product, asset class, sector or counterparty. It has the potential to affect adversely the Group's financial performance and capital.	During 2013, loan impairment charges were £8.4 billion, of which £4.5 billion related to the creation of RCR and the related strategy. Excluding the increased impairments related to RCR, loan impairment losses fell by £1.4 billion. Impairment provisions covered risk elements in lending of £39.4 billion by 64%, up from 52% a year earlier. Credit risk RWAs fell by 16% to £313.4 billion, within which counterparty risk RWAs more than halved to £22.3 billion, reflecting risk reduction and core product focus in Markets as well as Non-Core disposals and run-off. Credit risk is managed using a suite of credit approval, risk concentration, early warning and problem management frameworks as well as associated risk management tools. The focus in 2013 was on the calibration of the credit control framework to align with Group risk appetite targets and the enhancement of existing Basel models. Refer to the Credit risk and Balance sheet analysis sections on pages 222 to 312 for further information.
Market risk	The risk of loss arising from fluctuations in interest rates, credit spreads, foreign currency rates, equity prices, commodity prices and other risk-related factors	Arises from: Adverse movements in market prices. Character and impact: Characterised by frequent small losses, which are material in aggregate, and infrequent large material losses due to stress events.	During 2013, the Group continued to reduce its risk exposures. Average trading value-at-risk (VaR) decreased significantly from £97 million to £79 million, reflecting risk reduction and capital management focus. De-risking within the rates business and improvements in the capture of valuation adjustment risks within the counterparty exposure management desk in Markets helped reduce VaR in the first half

such as market volatilities that may lead to a reduction in earnings, economic value or both.	It has the potential to materially affect financial performance in Markets, International Banking, Non-Core and Group Treasury where the Group has the majority of its exposures. The Group's non-trading activities in retail and commercial businesses can also be affected through interest rate risk and foreign exchange non traded exposures.	of 2013. Ongoing reductions in the asset-backed securities inventory drove down the risk even further in the second half of 2013. Refer to the Market risk section on pages 313 to 335 for further information.

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Business review Risk and balance sheet management

Risk appetite*: Risk coverage continued

Risk type	Definition	Features	How the Group manages risk and the focus in 2013
Country risk	The risk of losses occurring as a result of either a country event or unfavourable country operating conditions.	Arises from: Sovereign events, economic events, political events, natural disasters or conflicts. Character and impact: Primarily present in credit portfolios of Markets, International Banking, Ulster Bank (Ireland), Group Centre (mainly Treasury), US Retail & Commercial and Non-Core. It has the potential to affect parts of the Group's credit portfolio that are directly or indirectly linked to the country in question.	The Group Country Risk Committee manages country risk matters including: risk appetite; risk management strategy and framework; risk exposure and policy; sovereign ratings; sovereign loss given default rates; and country Watchlist colours, with escalation where needed to the Executive Risk Forum. Regular, detailed reviews are carried out on all portfolios to ensure their composition remains in line with the Group's country risk appetite and reflects economic and political developments. A country risk Watchlist process identifies emerging issues and assists in the development of mitigation strategies. In 2013, the scope of this process was widened to include all countries with Group exposure. Balance sheet exposure to eurozone periphery countries continued to fall, and was down by 11% to £52.9 billion at the end of 2013, of which 70% related to Ireland, primarily reflecting exposures in Ulster Bank. Refer to the Country risk section on pages 336 to 348 for further information.
Conduct risk	The risk that the conduct of the Group and its staff towards its customers, or within the markets	Arises from: Breaches of regulatory rules or laws, resulting from the Group's retail or wholesale conduct; or from failing to meet customers' or regulators'	Conduct risk is managed through the Group's Conduct Risk Committee, under delegated authority from the Executive Risk Forum. The Committee is responsible for governance, leadership and risk appetite.

in which it operates, leads to reputational damage and/or financial loss.	expectations of the Group. Character and impact: Failures in product design, training and competence, complaint handling and transaction reporting can lead to an increase in complaints, compensation claims and regulatory censure. It has the potential to affect earnings (through loss of customer confidence and sales), as well as capital and liquidity (including regulator imposed fines for inappropriate conduct). It also affects the confidence of other key Group stakeholders, such as private and institutional shareholders, regulators and governments.	The focus in 2013 was on placing conduct risk at the centre of the Group's philosophy and on completing the development of the risk framework. Promoting understanding of conduct issues and ensuring compliance with regulations and rules are priorities for the Group. Refer to the Conduct risk section on pages 350 and 351 for further information.

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Risk appetite*: Risk coverage continued

Risk type	Definition	Features	How the Group manages risk and the focus in 2013
Pension risk	The risk to a firm caused by its contractual or other liabilities to, or with respect to, its pension schemes, whether established for its employees or for those of a related company or otherwise. It also means the risk that the firm will make payments or other contributions to, or with respect to, a pension scheme because of a moral obligation, or because the firm considers that it needs to do so for some other reason.	Arises from: Variation in value of pension scheme assets and liabilities owing to changes to life expectancy, interest rates, inflation, credit spreads, and equity and property prices. Character and impact: Pension schemes' funding positions can be volatile due to the uncertainty of future investment returns and the projected value of schemes' liabilities. The Group might have to make financial contributions to, or with respect to, its pension schemes. It has the potential to adversely affect the Group's funding and capital requirements.	The Group's Pension Risk Committee considers the Group's view of pension risk, mechanisms that could be used for managing pension risk and the financial strategy implications of the pension schemes as well as reviewing fund performance. The Committee reports to the Group Asset and Liability Committee on the material pension schemes that the Group is obliged to support. In 2013, various pension risk stress testing initiatives were undertaken, focused both on internally defined scenarios and on scenarios designed to meet integrated PRA stress testing requirements. Refer to the Pension risk section on pages 351 and 352 for further information.
Operational risk	The risk of loss resulting from inadequate or failed processes, people, systems or from external events.	Arises from: The Group's day-to-day operations and is relevant to every aspect of the Group's business. Character and impact: May be financial in nature (characterised by either frequent small losses or infrequent material losses), or may lead to direct customer and/or reputational impact (for example, a major IT systems failure or	Operational risk is managed by the Operational Risk Executive Committee. It is responsible for identifying and managing emerging operational risks, and for reviewing and monitoring operational risk profile strategies and frameworks, ensuring they are in line with risk appetite. In 2013, the focus was on continued implementation and embedding of risk assessments across the Group, including the strengthening of links between risk assessments and other elements of the Group operational risk

		fraudulent activity). It has the potential to affect the Group's profitability and capital requirements directly, as well as stakeholder confidence.	framework. In addition, risk assessments were increasingly used to identify single points of failure. Refer to the Operational risk section on pages 353 to 355 for further information.
Regulatory risk	The risk of material loss or liability, legal or regulatory sanctions, or reputational damage, resulting 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 the Group operates.	Arises from: The Group's regulatory, business or operating environment, and in how it responds to these. Character and impact: The crystallisation of regulatory risk can result in adverse impacts on the Group's customers, strategy, business, financial condition or reputation, for instance, through the failure to provide appropriate protections to customers, or from regulatory enforcement or other interventions. It has the potential to adversely impact the Group's customers, strategy, business, financial condition or reputation.	The management of regulatory (as well as conduct) risk is overseen by the Conduct and Regulatory Affairs function. The Group's existing Compliance and Regulatory Affairs teams were brought together in the second half of 2013, following the creation of the role of Group Head of Conduct and Regulatory Affairs. The Conduct and Regulatory Affairs function has responsibility for setting Group-wide policy and standards, providing advice to the business and ensuring controls are effective for managing regulatory affairs, compliance and financial crime risks across all businesses. Other enhancements were also made during 2013 included the creation of a more centralised approach to assurance activities and the introduction of a new 'Centres of Excellence' model for the management of regulatory developments, bringing together divisional and functional resources to manage issues more effectively. Refer to the Regulatory risk section on page 355 and 356 for further information.

*unaudited

Risk appetite*: Risk coverage continued

Risk type	Definition	Features	How the Group manages risk and the focus in 2013
Reputational risk	The risk of brand damage and/or financial loss due to a failure to meet stakeholders' expectations of the Group.	Arises from: Actions taken (or, in some cases, not taken) by the Group, as well as its wider policies and practices. Character and impact: Can result in an inability to build or sustain customer relationships, in low staff morale, in regulatory censure, or in reduced access to funding.	The reputational risk framework is aligned with the Group's focus on serving customers well, strategic objectives and the risk appetite goal of maintaining stakeholder confidence. In 2013, the environmental, social and ethical risk management function was set up to address the reputational risk associated with the clients the Group chooses to do business with. It sets policy and provides guidance to avoid reputational risk relating to business engagements and lending to clients in sensitive industry sectors. Refer to the Reputational risk section on pages 356 and 357 for further information.
Business risk	The risk of losses as a result of adverse variance in the Group's revenues and/or costs relative to its business plan and strategy.	Arises from: Internal factors such as volatility in pricing, sales volumes and input costs, and/or by external factors such as exposure to macroeconomic, regulatory and industry risks. Character and impact: Can lead to adverse changes in revenues and/or costs. It has the potential to directly affect the Group's profitability and capital requirements, as well as stakeholder confidence.	The Group Board has ultimate responsibility for business risk through the achievement of the Group's business plan. The primary responsibility for divisional financial performance rests with the divisional CEO supported by divisional Executive Committee and functions. In 2013, the management and measurement of business risk was enhanced with an increased focus on stress testing. The Group responded to business risk challenges by focusing on the management of net interest margin in order to sustain and grow revenues. In addition, it introduced cost management programmes to deliver substantial savings.

			Refer to the Business risk section on pages 357 and 358 for further information.
Strategic risk	The risk that the Group will make inappropriate strategic choices, or that there will be changes in the external environment to which the Group fails to adapt its strategies.	Arises from: the Group's management of its strategy. Character and impact: Varied losses affecting earnings, capital, liquidity and customer and stakeholder confidence. Can affect all divisions.	The Group is focusing on reducing strategic risk following a wide-ranging review to analyse core activities and formulate an appropriate plan, including rationalisation where necessary, to address the business challenges of the next five years. The successful execution of this strategy is set against a background of increasing regulatory demands and scrutiny as well as a challenging macroeconomic environment. Successful and timely execution of the strategy will be key to the future success of the Group. Refer to the Strategic risk section on pages 358 and 359 for further information.
Political risk	The risk to the Group's business and operations of the referendum on Scottish independence.		During 2013 the focus on the question of potential Scottish independence from the UK heightened, and the Scottish government will be holding a referendum in September 2014. A vote in favour of Scottish independence would be likely to impact the Group's costs and could also impact the fiscal, legal and regulatory landscape to which the Group is subject. Were Scotland to become independent, it may also affect Scotland's status in the European Union.

*unaudited

Capital management

Capital management*

Definition

The Group aims to maintain an appropriate level of capital to meet its business needs and regulatory requirements, and 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 the Group maintains sufficient capital to uphold customer, investor and rating agency confidence in the organisation, thereby supporting the business franchise and funding capacity.

2013 overview

The Group reported a Core Tier 1 ratio of 10.9% as at 31 December 2013. On a fully loaded Basel III basis, the Group's equivalent Common Equity Tier 1 (CET1) ratio was 8.6%.

The Group's Core Tier 1 ratio is higher than at the end of 2012 despite absorbing changes to credit model parameters and in the face of challenging economic headwinds and continuing costs of de-risking. This has been achieved through a continued focus on reshaping the Group's use of capital with the Group announcing in November 2013 management actions to accelerate the building of its capital strength. The measures include creation of an internal 'bad bank' to accelerate the run-down of high risk assets of £29 billion funded assets at the end of 2013.

Faster run-down of high risk assets entails accelerated and increased impairments and other adjustments in the fourth quarter of 2013, but the capital impact of this is significantly reduced by a commensurate reduction in expected loss capital deductions. The management strategy will result in a strengthening of the Group's capital ratios in the medium term.

The Group continues to target a fully loaded Basel III CET1 ratio of c.11% by the end of 2015 and 12% or above by the end of 2016.

The Group has announced plans to accelerate the divestment of RBS Citizens. Preparations for a partial initial public offering in 2014 are on track and the Group intends to fully divest the business by the end of 2016, benefiting CET1.

The Group continues to meet the minimum leverage ratio under both the Basel III and Capital Requirements Regulation (CRR) bases.

Focus for the Group remains on active de-risking of the balance sheet to meet strategic objectives, demonstrated in the leverage exposure measure by Non-Core asset disposal and run-off, and the downsizing of Markets business.

Regulatory developments

CRD IV

The European Union has implemented the Basel III proposals through the CRR and the Capital Requirements Directive (CRD), collectively known as CRD IV. CRD IV was implemented on 1 January 2014. The European Banking Authority's technical standards which will provide clarification of the CRD IV, are still to be finalised through adoption by the European Commission and implemented within the UK.

The Prudential Regulatory Authority (PRA) announced the acceleration of the end state rules for CET1 capital, whereby from 1 January 2014 the calculation is now closely aligned with the fully loaded definition. There will be no transitional arrangements applied to the prudential filters or regulatory deductions with the exception of unrealised gains on available for sale debt and equity which will be incorporated from 1 January 2015.

CRD IV and Basel III will impose a minimum CET1 ratio of 4.5% of RWAs. There are three buffers which will affect the Group: the capital conservation buffer set at 2.5%; the counter-cyclical capital buffer (up to 2.5% of RWAs), to be applied when macroeconomic conditions indicate areas of the economy are over-heating; and the Global-Systemically Important Bank buffer currently set at 1.5% for the Group. The regulatory target capital requirements will be phased in and are expected to apply in full from 1 January 2019, in the meantime using national discretion the PRA can apply a top-up. As set out in the PRA's Supervisory Statement SS3/13, the Group and other major UK banks and building societies are required to meet a CET1 ratio of 7% after taking into account certain adjustments set by the PRA.

PRA guidance indicates that from 1 January 2015, the Group must meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 capital. The Pillar 2A capital requirement is the additional capital that the Group must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

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

Governance

Governance and approach

The Group Asset and Liability Management Committee (GALCO) is responsible for ensuring the Group maintains adequate capital at all times. The 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 the 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 GALCO and comprises senior representatives from Risk Management, Group Finance and Group Treasury. Target capital ratios are set and monitored by the PRA for the Group. Management of capital is achieved by supervision of forecast capital and RWA over a five year time horizon.

Pillar 3

The Group's Pillar 3 disclosures provide additional analysis of exposure at default and credit risk measures such as credit risk mitigation, counterparty credit risk and provisions and their associated RWAs under the various Basel II approaches.

*unaudited

Capital management* continued

Governance continued

Determining appropriate capital

The Group's own determination of sufficient capital is derived from the desired credit rating, risk appetite and reflects the current and emerging regulatory requirements of the Group. It is evaluated through both internally and externally defined stress testing to identify potential changes in capital ratios in a range of scenarios.

Basel II requires RWAs to be calculated for credit, market and operational risk with various approaches available to banks, with differing levels of sophistication. The minimum capital requirement is calculated as 8% of RWAs.

The Group identifies the management and recovery actions that could be applied in 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, the Group aims to maintain capital adequacy, both at Group level and in each regulated entity.

The 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 positions of the regulated entities and the overall Group. In the event that the projected position might deteriorate beyond acceptable levels, the Group would issue further capital and/or revise business plans accordingly.

Stress testing approaches are used to determine the level of capital required to ensure the Group expects to remain adequately capitalised.

Minimising surplus profits and capital

The Group has a process in place which requires surplus distributable profits of all Group subsidiaries, after making allowance for sufficient capital to support current and prospective growth in the following half-year, to be repatriated by way of a dividend on a half yearly basis and paid in cash before the period end. Surplus is defined as subsidiary capital of more than £1 million in excess of the regulatory minimum for UK banks and in accordance with the Group's policy, including capital buffers, or the industry specific/overseas regulatory requirements. However, fungibility of capital is subject to the approval of the local regulator.

Capital allocation

Capital resources are allocated to the Group's businesses based on key performance parameters agreed by the Group 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 target returns set by the Group Board. The allocations also reflect strategic priorities, the intensity of regulatory capital use and the usage of other key Group resources such as balance sheet liquidity and funding.

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.

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

The divisions use return on capital metrics when making pricing decisions on products and transactions, to ensure customer activity is appropriately aligned with Group and divisional targets and allocations.

The PRA uses the risk asset ratio as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its RWAs (the assets and off-balance sheet exposures are weighted to reflect the inherent credit and other risks).

Economic capital

Economic capital is an internal measure of the risks to which the Group is exposed and is used as a supplement to other risk and capital tools, such as stress testing and regulatory capital. The measure includes risk exposures for credit, market, business, operational, pension, fixed asset and interest rate risk in the banking book. These models capture risks not fully addressed within the Pillar 1 regulatory framework e.g. concentration, pension, interest rate, business risk and diversification.

The characteristics of the models are consistent across risks, business lines and throughout the economic cycle, but are also flexible to allow outcomes to be employed for a number of purposes e.g. severity level/confidence interval, time horizon and correlations. Models have been developed internally but are subject to rigorous governance including external benchmarking, independent validation and extensive internal review and challenge. Models are regularly reviewed and continue to be updated for new data sources and improvements in risk modelling methodology.

The ability to change severity levels supports management of earnings volatility and capital risk. Economic models are used in the Internal Capital Adequacy Assessment Process, assessing risk profiles within the risk appetite framework, functional risk management e.g. credit exposures at both Group and business levels, assessing business line profitability on a risk adjusted basis and the management and allocation of capital.

*unaudited

Capital management* continued

Capital resources

The Group's capital, RWAs and risk asset ratios, on the basis of current rules (Basel 2.5) and CRR or fully loaded Basel III (FLB3), calculated in accordance with PRA definitions, are set out below.

Current rules	2013	2012	2011
Capital	£bn	£bn	£bn
Core Tier 1	42.2	47.3	46.3
Core Tier 1 (excluding Asset Protection Scheme (APS) in 2011)	42.2	47.3	49.1
Tier 1	50.6	57.1	57.0
Total	63.7	66.8	60.7
RWAs by risk			
Credit risk			
- non-counterparty	291.1	323.2	344.3
- counterparty	22.3	48.0	61.9
Market risk	30.3	42.6	64.0
Operational risk	41.8	45.8	37.9
	385.5	459.6	508.1
APS relief	—	—	(69.1)
	385.5	459.6	439.0
Risk asset ratios	%	%	%
Core Tier 1	10.9	10.3	10.6
Core Tier 1 (excluding APS in 2011)	10.9	10.3	9.7
Tier 1	13.1	12.4	13.0
Total	16.5	14.5	13.8

Estimated FLB3 (1)	2013	2012
CET1 capital	£36.8bn	£37.9bn
RWAs	£429.1bn	£494.6bn
CET1 ratio	8.6%	7.7%
Leverage ratio	3.5%	3.1%

Note:

(1) Calculated on the basis disclosed on page 194.

Key points

- Core Tier 1 capital ratios, under current rules and the fully loaded Basel III basis, improved by 60 basis points and 90 basis points respectively in the year. The benefit of lower RWAs was partially offset by the significant attributable loss for the year. The establishment of RCR and the related impairments reduced the ratios by c.10 basis points and c.20 basis points respectively.

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RWA decreases under current rules were primarily in Markets (£36.8 billion) as a result of balance sheet and risk reduction, and in Non-Core (£31.2 billion) reflecting disposal of capital intensive portfolios and run-off.

*unaudited

Capital management* continued
Capital resources continued
Current capital resources and CRR capital estimate
A reconciliation between capital as reported under the current basis (Basel 2.5), transitional basis (PRA) and full basis (final CRR) is set out below.

Although the CRR text has been finalised, many of the Regulatory Technical Standards (RTS) are still draft. The finalisation of these could have a material impact in a number of areas such as the scope of the deduction for insignificant financial holdings. Further guidance is provided by the European Banking Authority through published Q&A.

The 'year 1 transitional basis' applies the rules as if 2013 was year 1 of the transition period. The full basis shows the same calculation based on a complete implementation of CRR. This is based on the Group's interpretation of the current rules and guidance.

In the first year of transition, the regulatory adjustments will be calculated under the new rules. The CRR deductions are determined by applying the transitional percentage (20% in year 1)(1). The residual balance will be deducted according to the current rules, except where the PRA has specified a different treatment.

The Group is well advanced in its preparations to comply with the new requirements. Given the phasing of both capital requirements and target levels, in advance of needing to comply with the fully loaded end state requirements, the Group will have the opportunity to continue to generate additional capital from earnings and take management actions to mitigate the impact of CRD IV.

The Group's CET1 ratio on a fully loaded basis at 31 December 2013, based on its interpretation of the rules is estimated at 8.6%(1).

The actual impact of CRD IV on capital ratios may be different as the requirements and related technical standards have not yet been finalised and will ultimately be subject to application by local regulators. The actual impact will also be dependent on required regulatory approvals and the extent to which further management action is taken prior to implementation.

Note:
(1) The PRA issued its consultative paper on implementing CRD IV (PS7/13) in December 2013. Under the draft proposals, there would be no transition in respect of the changes to the prudential filters and deductions from CET1. These proposals came into effect from 1 January 2014.

*unaudited

Business review Risk and balance sheet management

Capital management* continued
Capital resources continued

	2013			2012			2011
	Current basis (Basel 2.5) £m	Transitional basis (PRA) £m	Full basis (final CRR) £m	Current basis (Basel 2.5) £m	Transitional basis (draft CRR) £m	Full basis (draft CRR) £m	Current basis (Basel 2.5) £m
Shareholders' equity (excluding non-controlling interests)							
Shareholders' equity	58,742	58,742	58,742	68,678	68,678	68,168	75,367
Preference shares - equity	(4,313)	(4,313)	(4,313)	(4,313)	(4,313)	(4,313)	(4,313)
Other equity instruments	(979)	(979)	(979)	(979)	(979)	(979)	(979)
	53,450	53,450	53,450	63,386	63,386	62,876	70,075
Non-controlling interests							
Non-controlling interests	473	—	—	1,770	1,770	1,770	686
Regulatory adjustments to non-controlling interests	—	—	—	(1,367)	(1,367)	(1,770)	(259)
	473	—	—	403	403	—	427
Regulatory adjustments and deductions							
Own credit	726	601	601	691	691	493	(2,634)
Defined benefit pension fund adjustment	362	(172)	(172)	913	(144)	(144)	—
Net unrealised AFS losses	308	—	—	346	346	—	957
Cash flow hedging reserve	84	84	84	(1,666)	(1,666)	(1,666)	(879)
Other regulatory adjustments	(103)	(55)	(55)	(197)	—	—	571
Deferred tax assets	—	(2,260)	(2,260)	—	(323)	(3,231)	—
Prudential valuation adjustments	—	(781)	(781)	—	(310)	(310)	—
Qualifying deductions exceeding Additional Tier 1 (AT1) capital	—	—	—	—	(8,420)	—	—
Goodwill and other intangible assets	(12,368)	(12,368)	(12,368)	(13,545)	—	(13,956)	(14,858)
50% of expected losses less impairment provisions	(19)	(1,731)	(1,731)	(1,904)	—	(6,154)	(2,536)
50% of securitisation positions	(748)	—	—	(1,107)	—	—	(2,019)
50% of APS first loss	—	—	—	—	—	—	(2,763)
	(11,758)	(16,682)	(16,682)	(16,469)	(9,826)	(24,968)	(24,161)
Core Tier 1 capital	42,165	36,768	36,768	47,320	53,963	37,908	46,341
Other Tier 1 capital							
Preference shares - equity	4,313	—	—	4,313	—	—	4,313
Preference shares - debt	911	—	—	1,054	—	—	1,094
Innovative/hybrid Tier 1 securities	4,207	—	—	4,125	—	—	4,667
Qualifying Tier 1 capital and related share premium subject to phase out from AT1 capital	—	5,831	—	—	4,571	—	—

Qualifying Tier 1 capital included in consolidated AT1 capital issued by subsidiaries and held by third parties	—	1,749	—	—	4,042	—	—
	9,431	7,580	—	9,492	8,613	—	10,074
Tier 1 deductions							
50% of material holdings (1)	(976)	—	—	(295)	—	—	(340)
Tax on expected losses less impairment provisions	6	—	—	618	—	—	915
Other regulatory adjustments	—	—	—	—	(17,033)	—	—
	(970)	—	—	323	(17,033)	—	575
Qualifying deductions exceeding AT1 capital	—	—	—	—	8,420	—	—
Total Tier 1 capital	50,626	44,348	36,768	57,135	53,963	37,908	56,990

For the note to this table refer to the following page.

*unaudited

Capital management*: Capital resources continued

	2013			2012			2011
	Current basis (Basel 2.5) £m	Transitional basis (PRA) £m	Full basis (final CRR) £m	Current basis (Basel 2.5) £m	Transitional basis (draft CRR) £m	Full basis (draft CRR) £m	Current basis (Basel 2.5) £m
Qualifying Tier 2 capital							
Undated subordinated debt	2,109	—	—	2,194	—	—	1,838
Dated subordinated debt - net of amortisation	12,436	—	—	13,420	—	—	14,527
Qualifying items and related share premium	—	4,431	3,582	—	2,774	7,292	—
Qualifying own funds instruments issued by subsidiaries and held by third parties	—	9,374	5,151	—	12,605	5,185	—
Unrealised gains on AFS equity shares	114	—	—	63	—	—	108
Collectively assessed impairment provisions	395	—	—	399	399	399	635
Non-controlling Tier 2 capital	—	—	—	—	—	—	11
	15,054	13,805	8,733	16,076	15,778	12,876	17,119
Tier 2 deductions							
50% of securitisation positions	(748)	—	—	(1,107)	—	—	(2,019)
50% of standardised expected losses less impairment provisions	(25)	—	—	(2,522)	(3,077)	—	(3,451)
50% of material holdings (1)	(976)	—	—	(295)	—	—	(340)
50% of APS first loss	—	—	—	—	—	—	(2,763)
	(1,749)	—	—	(3,924)	(3,077)	—	(8,573)
Total Tier 2 capital	13,305	13,805	8,733	12,152	12,701	12,876	8,546
Supervisory deductions							
Unconsolidated investments							
- Direct Line Group (1)	—	—	—	(2,081)	—	—	(4,354)
- Other investments	(36)	—	—	(162)	—	—	(239)
Other deductions	(236)	—	—	(244)	—	—	(235)
	(272)	—	—	(2,487)	—	—	(4,828)
Total regulatory capital	63,659	58,153	45,501	66,800	66,664	50,784	60,708

The table below analyses the movement in Core Tier 1, Other Tier 1 and Tier 2 capital on a Basel 2.5 basis during the year ended 31 December 2013.

	Core Tier 1 £m	Other Tier 1 £m	Tier 2 £m	Supervisory deductions £m	Total £m
At 1 January 2013	47,320	9,815	12,152	(2,487)	66,800
Attributable loss net of movements in fair value of own credit	(8,961)	—	—	—	(8,961)
	200	—	—	—	200

Share capital and reserve movements in respect of employee share schemes					
Ordinary shares issued	264	—	—	—	264
Foreign exchange reserve	(217)	—	—	—	(217)
Foreign exchange movements	—	(93)	(106)	—	(199)
Actuarial gains recognised in retirement benefit schemes (net of tax)	200	—	—	—	200
Termination of contingent capital facility	320	—	—	—	320
Increase in non-controlling interests	70	—	—	—	70
Decrease/(increase) in capital deductions (1)	2,244	(1,293)	2,175	2,215	5,341
Decrease in goodwill and intangibles	1,177	—	—	—	1,177
Defined benefit pension fund	(551)	—	—	—	(551)
Dated subordinated debt issues	—	—	1,862	—	1,862
Dated subordinated debt maturities, redemptions and amortisation	—	—	(2,666)	—	(2,666)
Other movements	99	32	(112)	—	19
At 31 December 2013	42,165	8,461	13,305	(272)	63,659

Note:

(1) From 1 January 2013 material holdings in insurance companies are deducted 50% from Tier 1 and 50% from Tier 2.

*unaudited

Capital management* continued
Capital resources continued
The table below analyses the movement in CET1 and Tier 2 capital on a FLB3 basis during the year ended 31 December 2013.

	CET1 £m	Tier 2 £m	Total £m
At 1 January 2013	37,908	12,876	50,784
Attributable loss net of movements in fair value of own credit	(8,887)	—	(8,887)
Share capital and reserve movements in respect of employee share schemes	200	—	200
Ordinary shares issued	264	—	264
Nominal value of B shares	510	—	510
Foreign exchange reserve	(217)	—	(217)
Foreign exchange movements	—	(106)	(106)
Actuarial gains recognised in retirement benefit schemes (net of tax)	200	—	200
Termination of contingent capital facility	320	—	320
Decrease in goodwill and intangibles	1,588	—	1,588
Defined benefit pension fund	(28)	—	(28)
Deferred tax assets	971	—	971
Excess of expected loss over impairment provisions	4,423	—	4,423
Grandfathered instruments	—	(3,121)	(3,121)
Dated subordinated debt issues	—	1,862	1,862
Dated subordinated debt maturities, redemptions and amortisation	—	(2,666)	(2,666)
Prudential valuation adjustments (PVA)	(471)	—	(471)
Other movements	(13)	(112)	(125)
At 31 December 2013	36,768	8,733	45,501

Notes:
General:
In accordance with the PRA's Policy Statement PS7/13 issued in December 2013 on the implementation of CRD IV, all regulatory adjustments and deductions to CET1 have been applied in full (i.e. no transition) with the exception of unrealised gains on AFS securities which will be included from 2015.

CRD IV and Basel III will impose a minimum CET1 ratio of 4.5% of RWAs. There are three buffers which will affect the Group: the capital conservation buffer set at 2.5%; the counter-cyclical capital buffer (up to 2.5% of RWAs), to be applied when macroeconomic conditions indicate areas of the economy are over-heating; and the Global-Systemically Important Bank buffer currently set at 1.5% for the Group. The regulatory target capital requirements will be phased in and are expected to apply in full from 1 January 2019, in the meantime using national discretion the PRA can apply a top-up. As set out in the PRA's Supervisory Statement SS3/13, the Group and other major UK banks and building societies are required to meet a CET1 ratio of 7% after taking into account certain adjustments set by the PRA.

PRA guidance indicates that from 1 January 2015, the Group must meet at least 56% of its Pillar 2A capital requirement with CET1 capital and the balance with Additional Tier 1 capital. The Pillar 2A capital requirement is the additional capital that the Group must hold, in addition to meeting its Pillar 1 requirements in order to comply with the PRA's overall financial adequacy rule.

Estimates, including RWAs, are based on the current interpretation, expectations, and understanding of the CRR requirements, anticipated compliance with all necessary enhancements to model calibration and other refinements, as well as further regulatory clarity and implementation guidance from the UK and EU authorities. The actual CRR impact may differ from these estimates when the final technical standards are interpreted and adopted.

Capital base:

(1) Includes the nominal value of B shares (£0.5 billion) on the assumption that RBS will be privatised in the future and that they will count as permanent equity in some form by the end of 2017.

(2) The PVA, arising from the application of the prudent valuation requirements to all assets measured at fair value, has been included in full in line with the guidance from the PRA and uses methodology discussed with the PRA pending the issue of the final RTS by the European Banking Authority. The full amount of the applicable PVA has been included in provisions in the determination of the deduction for expected losses.

(3) Where the deductions from AT1 capital exceed AT1 capital, the excess is deducted from CET1 capital. The excess of AT1 deductions over AT1 capital in year one of transition is due to the application of the current rules to the transitional amounts.

(4) Insignificant investments in equities of other financial entities (net): long cash equity positions are considered to have matched maturity with synthetic short positions if the long position is held for hedging purposes and sufficient liquidity exists in the relevant market. All the trades are managed and monitored together within the equities business.

(5) Based on current interpretations of the final draft of the RTS on credit risk adjustments, issued in July 2013, the Group's standardised latent provision has been reclassified to specific provision and is therefore no longer included in Tier 2 capital.

Risk-weighted assets:

(1) Current securitisation positions are shown as risk-weighted at 1,250%.

(2) RWA uplifts include the impact of credit valuation adjustments and asset valuation correlation on banks and central counterparties.

(3) RWAs reflect implementation of the full internal model method suite, and include methodology changes that took effect immediately on CRR implementation.

(4) Non-financial counterparties and sovereigns that meet the eligibility criteria under CRR are exempt from the credit valuation adjustments volatility charges.

(5) The CRR final text includes a reduction in the risk-weight relating to small and medium-sized enterprises.

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Business review Risk and balance sheet management

Capital management* continued

Estimated leverage ratio

The Basel III agreement introduced a leverage ratio as a non-risk based backstop limit intended to supplement the risk-based capital requirements. It aims to constrain the build up of excess leverage in the banking sector, introducing additional safeguards against model risk and measurement errors.

The PRA's Supervisory Statement SS3/13 also states that the Group and the other major UK banks and building societies are expected to maintain a 3% end point Tier 1 leverage ratio, after taking into account the adjustments required by the PRA.

The transitional period for the introduction of this ratio started with a supervisory monitoring period in 2011, with a parallel run period from January 2013 to December 2017. A minimum ratio of 3% is applied initially. The requirement is expected to be included in Pillar 1 from January 2018.

The Basel III leverage percentages are lower than those currently reported, primarily due to changes in methodology relating to the inclusion of potential future exposure on derivatives and undrawn commitments. In addition, inclusion or exclusion of grandfathered capital instruments can result in material differences.

The leverage ratios set out below are based on:

- Tier 1 capital as set out in the final CRR text; and
- Exposure measure calculated using the final CRR text as well as the December 2010 Basel III text; further specificity being sourced from the instructions in the July 2012 Quantitative Impact Study and the related Frequently Asked Questions.

The estimated leverage ratio, based on the Basel Committee on Banking Supervision (BCBS) proposal issued in January 2014, is detailed below.

	2013				2012			
Estimated leverage ratio	Exposure £bn	Tier 1 capital £bn	Leverage	Leverage %	Exposure £bn	Tier 1 capital £bn	Leverage	Leverage %
CRR basis:								
Transitional measure	1,062.1	44.3	24x	4.2	1,205.2	54.0	22x	4.5
Full end point measure	1,062.1	36.8	29x	3.5	1,202.3	37.9	32x	3.1
Basel III basis:								
Transitional measure	1,093.5	44.3	25x	4.1	1,225.8	54.0	23x	4.4
Full end point measure	1,093.5	36.8	30x	3.4	1,222.9	37.9	32x	3.1
BCBS basis:								
Transitional measure	1,082.0	44.3	24x	4.1	1,239.8	54.0	23x	4.4
Full end point measure	1,082.0	36.8	29x	3.4	1,236.9	37.9	33x	3.1

Key points

- The Group's estimated leverage ratios, under both the CRR and Basel III texts, as well as the recently issued BCBS proposal are above 3%.

- Estimated leverage ratios on all full end point measure bases improved during the year reflecting downsizing in Markets and Non-Core as well as risk reduction and portfolio focus ahead of CRR implementation.

- The PRA Policy Statement PS7/13 requires an acceleration of the CRR transitional approach for computing the capital base. Thus the majority of CET1 capital deductions will apply with immediate effect. This causes a year-on-year reduction of around £10 billion in Tier 1 capital, causing the reduction in transitional measure leverage ratios.

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Business review Risk and balance sheet management

Capital management* continued

Estimated leverage ratio continued

	2013			2012		
	CRR basis	Basel III basis	BCBS basis	CRR basis	Basel III basis	BCBS basis
Exposure measure	£bn	£bn	£bn	£bn	£bn	£bn
Cash and balances at central banks	82.7	82.7	82.7	79.3	79.3	79.3
Debt securities	113.6	113.6	113.6	157.4	157.4	157.4
Equity shares	8.8	8.8	8.8	15.2	15.2	15.2
Derivatives	288.0	288.0	288.0	441.9	441.9	441.9
Loans and advances to banks and customers	418.4	418.4	418.4	459.3	459.3	459.3
Reverse repos	76.4	76.4	76.4	104.8	104.8	104.8
Goodwill and intangible assets	12.4	12.4	12.4	13.5	13.5	13.5
Other assets	24.6	24.6	24.6	26.9	26.9	26.9
Assets of disposal groups	3.0	3.0	3.0	14.0	14.0	14.0
Total assets	1,027.9	1,027.9	1,027.9	1,312.3	1,312.3	1,312.3
Netting of derivatives (1)	(233.8)	(233.8)	(227.3)	(369.8)	(369.8)	(358.4)
SFTs (1)	(41.5)	(12.0)	59.8	(45.9)	(23.1)	75.5
Regulatory deductions and other adjustments (2)	(4.9)	(4.9)	(6.6)	(14.9)	(14.9)	(20.9)
Potential future exposure on derivatives (3)	131.3	130.4	128.0	133.1	130.9	125.8
Undrawn commitments (4)	183.1	185.9	100.2	187.5	187.5	102.6
End point leverage exposure measure	1,062.1	1,093.5	1,082.0	1,202.3	1,222.9	1,236.9
Transitional adjustments to assets deducted from regulatory Tier 1 capital				2.9	2.9	2.9
Transitional leverage exposure measure	1,062.1	1,093.5	1,082.0	1,205.2	1,225.8	1,239.8

Notes:

(1) Under the Basel III view, the balance sheet value is reduced for allowable netting under the Basel II framework (excluding cross-product netting) which mainly relates to cash positions under a master netting agreement. In the CRR calculation, the balance sheet value is replaced with the related regulatory exposure value which has netting of both cash positions and related collateral of securities financing transactions (SFTs). The BCBS view permits the effects of master netting agreements for calculation of counterparty exposure but with very tight restrictions upon the recognition of those agreements for offset of cash received.

(2) Regulatory deductions: to ensure consistency between the numerator and the denominator, items that are deducted from capital are also deducted from total assets. For the BCBS basis, the shortfall in the stock of eligible provisions relative to expected losses is adjusted.

(3) Potential future exposure (PFE) on derivatives: the regulatory add-on which is calculated by assigning percentages based on the type of instrument and the residual maturity of the contract to the nominal amounts or underlying values of derivative contracts. Under the latest BCBS proposal, variation margin is permitted to be offset against the replacement cost for derivative exposures (but not the PFE) where specific conditions are met. Refer to the table below for further analysis.

(4) Undrawn commitments represent regulatory add-ons relating to off-balance sheet undrawn commitments based on a 10% credit conversion factor for unconditionally cancellable commitments and 100% for other commitments. The CRR basis uses the credit conversion factor (CCF) as per risk measure for medium to low risk trade finance and officially supported export credits. For the BCBS measure, commitments other than securitisation liquidity facilities with an original maturity up to one year and commitments with an original maturity over one year will

receive a CCF of 20% and 50%, respectively. Refer to page 197 for further analysis.

Derivative notionals

The table below analyses derivative notional values by product and maturity.

2013	<1 year £bn	1-5 years £bn	>5 years £bn	Credit derivative 5% add on factor (1) £bn	Credit derivative 10% add on factor (1) £bn	Total £bn
Interest rate	10,582	16,212	8,795			35,589
Exchange rate	3,261	814	480			4,555
Equity	43	35	1			79
Commodities	—	1	1			2
Credit risk				189	64	253
Total	13,886	17,062	9,277	189	64	40,478
2012						
Interest rate	12,515	12,980	7,988			33,483
Exchange rate	3,411	795	492			4,698
Equity	51	52	4			107
Commodities	2	—	2			4
Credit risk				470	83	553
Total	15,979	13,827	8,486	470	83	38,845

Note:

(1) Credit derivatives in the trading book receive a PFE of 10%. Any credit derivatives in respect of a company in which a direct holding would give the Group 10% or more of the voting rights, receive a PFE of 5%.

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Capital management* continued
Estimated leverage ratio continued
Off-balance sheet items

2013	UK Retail £bn	UK Corporate £bn	International Banking (1) £bn	US Retail & Commercial £bn	Markets £bn	Other £bn	Total £bn
Unconditionally cancellable items (2)	3.1	0.5	0.6	1.7	—	0.3	6.2
Other contingents and commitments	9.6	36.3	95.4	16.8	8.9	12.7	179.7
	12.7	36.8	96.0	18.5	8.9	13.0	185.9
2012							
Unconditionally cancellable items (2)	3.0	0.5	0.8	1.8	—	0.6	6.7
Other contingents and commitments	9.3	33.9	102.6	15.6	12.3	7.1	180.8
	12.3	34.4	103.4	17.4	12.3	7.7	187.5

Notes:
(1) International Banking facilities are primarily undrawn facilities to large multinational corporations, many of which are domiciled in the UK.
(2) Based on a 10% credit conversion factor.

Risk-weighted assets
The table below analyses the movement in credit risk RWAs by key drivers during the year.

	Credit risk Non-counterparty £bn	Counterparty £bn	Total £bn
At 1 January 2013	323.2	48.0	371.2
Foreign exchange movement	(1.7)	(0.3)	(2.0)
Business movements	(27.4)	(4.9)	(32.3)
Risk parameter changes (1)	(11.0)	(2.9)	(13.9)
Methodology changes (2)	1.4	(16.1)	(14.7)
Model updates (3)	15.3	(1.5)	13.8
Disposals	(8.6)	—	(8.6)
Other changes	(0.1)	—	(0.1)
At 31 December 2013	291.1	22.3	313.4

Notes:
(1) Relates to changes in credit quality metrics of customers and counterparties such as probability of default and loss given default.
(2) Relates to internal treatment of exposures or calibration of models and regulatory prescribed changes.
(3) Refers to implementation of a new model or modification of an existing model following approval by the PRA and includes:
- o exposure at default treatment (£4.8 billion) in the second quarter of 2013;
- o continuation of commercial real estate slotting (£4.4 billion) throughout 2013; and
- o loss given default changes to the shipping portfolio (£3.7 billion) in the second half of 2013.

The table below analyses movements in market and operational risk RWAs during the year.

	Market risk				
	Markets £bn	Other £bn	Total £bn	Operational risk £bn	Total £bn
At 1 January 2013	36.9	5.7	42.6	45.8	88.4
Business and market movements	(9.0)	(1.8)	(10.8)	(4.0)	(14.8)
Model updates (1)	(1.5)	—	(1.5)	—	(1.5)
At 31 December 2013	26.4	3.9	30.3	41.8	72.1

Note:
(1) Market risk model updates in 2013 primarily related to valuation adjustments.

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Business review Risk and balance sheet management

Capital management* continued

Risk-weighted assets continued

The table below analyses RWA movements by division during the year.

Total RWAs	UK Retail £bn	UK Corporate £bn	Wealth £bn	IB (1) £bn	Ulster Bank £bn	US R&C (1) £bn	Markets £bn	Other £bn	Core £bn	Non-Core £bn	RFS MI £bn	Total £bn
At 1 January 2013	45.7	86.3	12.3	51.9	36.1	56.5	101.3	5.8	395.9	60.4	3.3	459.6
Business and market movements	(1.8)	(9.6)	(0.3)	(6.0)	(5.7)	(0.4)	(35.1)	2.7	(56.2)	(22.2)	0.6	(77.8)
Disposals	—	—	—	—	—	—	—	—	—	(8.6)	—	(8.6)
Model updates	—	9.4	—	3.1	0.3	—	(1.7)	1.6	12.7	(0.4)	—	12.3
At 31 December 2013	43.9	86.1	12.0	49.0	30.7	56.1	64.5	10.1	352.4	29.2	3.9	385.5

Note:

(1) IB: International Banking; R&C: Retail & Commercial.

Key points

- RWAs were down £74.1 billion or 16% overall, of which £57.8 billion related to credit risk, £12.3 billion to market risk and £4.0 billion to operational risk.

- Credit risk RWAs were down £57.8 billion or 16% to £313.4 billion despite absorbing £13.8 billion of higher RWAs due to model updates.

  - Non-counterparty RWAs were down £32.1 billion or 10% to£291.1 billion: in Non-Core (£24.1 billion) due to run-off anddisposals in commercial real estate, shipping and leveragedfinance portfolios; and in Retail & Commercial (£10.0 billion)due to loans migrating into default, risk parameter changes and balance sheet reduction.

  - Counterparty RWAs were down £25.7 billion or 54% to £22.3billion in Markets (£17.2 billion) and Non-Core (£7.8 billion).Methodology changes, significantly all in Markets,reflectedextension of product coverage improvements in models andreduction in weighting applied for exposure at default. This was partially offset by the impact of higher loss given defaults for hedge funds.

- Market risk RWAs were down £12.3 billion or 29% to £30.3 billion significantly all in Markets reflecting balance sheet and risk reduction £9.0 billion and model changes of £1.5 billion.

- Operational risk RWAs were down £4.0 billion or 9% to £41.8 billion primarily due to reductions in Markets.

For additional analyses on RWAs by sector and related density see pages 202 and 203.

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Capital management* continued

Risk-weighted assets continued

FLB3 and Basel 2.5

The following tables set out RWAs under future and current rules.

	Estimated FLB3	Basel 2.5
2013	£bn	£bn
UK Retail	43.9	43.9
UK Corporate	82.9	86.1
Wealth	12.0	12.0
International Banking	50.3	49.0
Ulster Bank	30.1	30.7
US Retail & Commercial	58.8	56.1
Retail & Commercial	278.0	277.8
Markets	99.9	64.5
Centre	13.1	10.1
Core	391.0	352.4
Non-Core	34.2	29.2
Group before RFS Holdings minority interest	425.2	381.6
RFS Holdings minority interest	3.9	3.9
Group	429.1	385.5

Key points

- Estimated FLB3 RWAs were £43.6 billion or 11% higher than under current rules principally reflecting:
  - °Treatment of securitisations as risk-weighted at 1,250% instead of as capital deductions, £18.7 billion.
  - °Credit valuation adjustments, £16.7 billion and financial institution asset valuation correlation, £5.6 billion.
  - °Other model and methodology changes, £7.2 billion.
  - °Reduced risk-weighting for small and medium-sizedenterprises, £4.6 billion, mainly in UK Corporate.

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Business review Risk and balance sheet management

Capital management* continued
Reconciliation between accounting and regulatory consolidation
The table below provides a reconciliation between accounting and regulatory consolidation.

	2013				2012		
	Accounting balance sheet £m	Deconsolidation of insurance and other entities (1) £m	Consolidation of banking associates/ other entities (2) £m	Regulatory consolidation £m	Accounting balance sheet £m	Deconsolidation of insurance and other entities (1) £m	Consolidation of banking associates/ other entities (2) £m
Assets							
Cash and balances at central banks	82,659	—	430	83,089	79,290	—	544
Loans and advances to banks	54,071	(66)	113	54,118	63,951	(30)	48
Loans and advances to customers	440,722	1,257	3,459	445,438	500,135	1,438	2,883
Debt securities	113,599	(7)	1,086	114,678	157,438	(12)	743
Equity shares	8,811	(3)	—	8,808	15,232	(194)	—
Settlement balances	5,591	—	—	5,591	5,741	—	—
Derivatives	288,039	—	—	288,039	441,903	—	—
Intangible assets	12,368	—	—	12,368	13,545	—	—
Property, plant and equipment	7,909	(948)	32	6,993	9,784	(1,320)	32
Deferred tax	3,478	—	—	3,478	3,443	—	—
Prepayments, accrued income and other assets	7,614	(488)	(533)	6,593	7,820	(77)	(320)
Assets of disposal groups	3,017	—	—	3,017	14,013	(10,544)	—
	1,027,878	(255)	4,587	1,032,210	1,312,295	(10,739)	3,930
Liabilities							
Deposits by banks	63,979	—	161	64,140	101,405	—	92
Customer accounts	470,880	(5)	3,989	474,864	521,279	—	3,486
	67,819	—	—	67,819	94,592	—	—

Debt securities in issue							
Settlement balances	5,313	—	—	5,313	5,878	—	—
Short positions	28,022	—	—	28,022	27,591	—	—
Derivatives	285,526	(208)	—	285,318	434,333	—	—
Accruals, deferred income and other liabilities	16,017	(33)	139	16,123	14,801	(100)	253
Retirement benefit liabilities	3,210	—	—	3,210	3,884	—	—
Deferred tax	507	(9)	—	498	1,141	(5)	—
Subordinated liabilities	24,012	—	298	24,310	26,773	—	99
Liabilities of disposal groups	3,378	—	—	3,378	10,170	(9,267)	—
	968,663	(255)	4,587	972,995	1,241,847	(9,372)	3,930
Non-controlling interests	473	—	—	473	1,770	(1,367)	—
Owners' equity	58,742	—	—	58,742	68,678	—	—
Total equity	59,215	—	—	59,215	70,448	(1,367)	—
	1,027,878	(255)	4,587	1,032,210	1,312,295	(10,739)	3,930

Notes:

(1) The Group can only include particular types of subsidiary undertaking in the regulatory consolidation. Insurance undertakings and non-financial undertakings are excluded from the regulatory consolidation, although they are included in the consolidation for financial reporting.

(2) The Group must proportionally consolidate its associates for regulatory purposes where they are classified as credit institutions or financial institutions. These will generally have been equity accounted for financial reporting purposes.

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Business review Risk and balance sheet management

Capital management* continued

Balance sheet to exposure at default bridge

The table below provides a bridge between the balance sheet and credit exposure at default (EAD) by balance sheet caption.

				Other regulatory adjustments					
2013	Balance sheet £bn	Consolidation differences (1) £bn	Regulatory consolidation £bn	Within the scope of market risk (2) £bn	Credit provisions (3) £bn	Netting and collateral (4) £bn	Capital deduction (5) £bn	Methodology differences and reclassi-fications (6) £bn	Total drawn EAD £bn
Cash and balances at central banks	82.7	0.4	83.1	—	—	—	—	1.7	84.8
Reverse repurchase agreements and stock borrowing	76.4	—	76.4	—	—	(51.3)	—	—	25.1
Loans and advances	418.4	4.7	423.1	—	25.2	(28.4)	(0.4)	(7.9)	411.6
Debt securities	113.6	1.1	114.7	(56.7)	0.3	—	(1.5)	2.0	58.8
Equity shares	8.8	—	8.8	(7.2)	0.1	—	—	(0.1)	1.6
Settlement balances	5.6	—	5.6	(5.6)	—	—	—	—	—
Derivatives	288.0	—	288.0	—	1.8	(242.8)	—	(2.1)	44.9
Intangible assets	12.4	—	12.4	—	—	—	(12.4)	—	—
Property, plant and equipment	7.9	(0.9)	7.0	—	—	—	—	0.7	7.7
Deferred tax	3.5	—	3.5	—	—	—	—	—	3.5
Prepayments, accrued income and other assets	7.6	(1.0)	6.6	—	—	—	(1.1)	(5.5)	—
Assets of disposal groups	3.0	—	3.0	—	—	—	—	(3.0)	—
Total assets	1,027.9	4.3	1,032.2	(69.5)	27.4	(322.5)	(15.4)	(14.2)	638.0
Contingent obligations									

(7)

Notes:

(1) Represents proportional consolidation of associates and deconsolidation of certain subsidiaries, as required by regulatory rules. Refer to previous page for additional details.

(2) The exposures in regulatory trading book businesses are subject to market risk and are therefore excluded from EAD. Refer to the Market risk section on page 313.

(3) Impairment loss provisions on loans and advances and securities, and credit valuation adjustment on derivatives.

(4) Includes:

- Reverse repos: reflects regulatory approach for securities financing transactions including netting of collateral and cash legs.
- Loans and advances: cash collateral pledged with counterparties in relation to net derivative liability positions.
- Derivatives: impact of master netting arrangements.

(5) Capital deductions are excluded as EAD only captures exposures for credit RWAs.

(6) Comprises:

- Cash and balances at central banks: notice balances with central banks included in loans and advances, reclassified as central bank balances for EAD.
- Loans and advances: includes offset related to cash management pooling arrangements not allowed under IFRS, standardised approach credit risk mitigation and reclassification of central bank balances. This is partially offset by the reclassification of disposal groups and prepayments, accrued income and other assets as customer balances.
- Debt securities: gross up of banking book securities that are matched by trading book short positions that cannot be offset under regulatory rules.
- Derivatives: reflects difference between netting arrangements and netting within regulatory model sets as well as EAD valuation adjustments.
- Property, plant and equipment: includes residual value of operating leases.
- Prepayments, accrued income and other assets: includes amounts reclassified to loans and advances.
- Assets of disposal groups: amounts reclassified to relevant balance sheet lines for EAD.

(7) Includes documentary credits (commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents), classified as commitments for financial reporting, and amounts related to entities proportionally consolidated for regulatory reporting.

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Business review Risk and balance sheet management

Capital management* continued

RWA density

The table below analyses EAD, RWAs and related RWA density by sector cluster.

	EAD									RWAs				
	EAD post CRM (1)													
2013	Non-CCR credit risk £m	CCR (2) £m	Total £m	Drawn balance £m	On-balance sheet EAD £m	Undrawn £m	Undrawn EAD £m	Off-balance sheet £m	Off-balance sheet EAD £m	RWAs £m	On-balance sheet RWAs £m	Undrawn RWAs £m	Off-balance sheet RWAs £m	EAD post CRM %
Sovereign														
Central banks	82,015	12,145	94,160	92,727	94,073	75,537	3	—	84	1,469	1,468	—	1	2
Central government	25,394	947	26,341	25,551	26,238	594	102	3	1	2,448	2,439	9	—	9
Other sovereign	9,560	1,288	10,848	11,788	10,405	1,759	401	47	42	1,600	1,535	59	6	15
Total sovereign	116,969	14,380	131,349	130,066	130,716	77,890	506	50	127	5,517	5,442	68	7	4
Financial institutions (FI)														
Banks	23,744	16,743	40,487	45,878	33,948	20,787	1,147	5,419	5,392	12,611	10,574	357	1,680	31
Other FI	37,679	19,814	57,493	47,640	49,158	19,865	5,056	3,510	3,279	24,331	20,803	2,140	1,388	42
SPVs (4)	20,416	3,671	24,087	22,127	21,661	2,584	2,419	7	7	8,016	7,209	805	2	33
Total FI	81,839	40,228	122,067	115,645	104,767	43,236	8,622	8,936	8,678	44,958	38,586	3,302	3,070	37
Corporates														
Property - Western Europe														
- UK	50,675	2,346	53,021	49,644	47,222	10,587	5,057	870	742	27,792	24,752	2,651	389	52
- Ireland	10,295	150	10,445	10,903	10,184	435	228	71	33	5,796	5,652	126	18	55
- Other	7,913	994	8,907	8,705	7,706	3,433	730	1,032	471	5,067	4,384	415	268	57
	7,469	184	7,653	5,797	5,839	3,790	1,468	466	346	6,872	5,243	1,318	311	90

- US														
- RoW	3,291	605	3,896	3,199	3,320	1,281	268	575	308	3,070	2,617	211	242	79
Total property	79,643	4,279	83,922	78,248	74,271	19,526	7,751	3,014	1,900	48,597	42,648	4,721	1,228	58
Natural resources	28,242	3,987	32,229	21,150	19,599	37,292	8,750	5,014	3,880	18,021	10,960	4,892	2,169	56
Transport	32,017	2,684	34,701	28,773	27,893	14,837	4,680	3,328	2,128	24,387	19,603	3,289	1,495	70
Manufacturing	31,426	998	32,424	24,029	21,256	31,132	8,700	3,785	2,468	21,206	13,902	5,690	1,614	65
Retail and leisure	30,473	1,245	31,718	28,429	25,301	17,161	4,923	1,786	1,494	25,893	20,655	4,018	1,220	82
Services	30,168	1,305	31,473	28,548	26,291	9,722	3,866	1,553	1,316	24,354	20,345	2,991	1,018	77
TMT (5)	14,911	861	15,772	15,811	10,127	15,933	4,609	1,578	1,036	10,668	6,849	3,118	701	68
Total corporate	246,880	15,359	262,239	224,988	204,738	145,603	43,729	20,058	14,222	173,126	134,962	28,719	9,445	66
Personal														
Mortgages														
- Western Europe														
- UK	118,311	—	118,311	108,690	108,700	9,796	9,570	41	41	17,679	16,243	1,430	6	15
- Ireland	17,181	—	17,181	16,841	16,841	62	340	—	—	16,120	15,800	320	94	—
- Other	709	—	709	687	688	20	21	—	—	227	220	7	32	—
- US	19,838	—	19,838	19,753	19,782	9,913	56	—	—	9,771	9,744	27	49	—
- RoW	638	—	638	599	599	46	39	—	—	157	147	10	25	—
Total mortgages	156,677	—	156,677	146,570	146,610	19,837	10,026	41	41	43,954	42,154	1,794	6	28
Other personal	47,826	53	47,879	30,030	29,187	40,829	18,135	634	557	25,989	15,843	9,844	302	54
Total personal	204,503	53	204,556	176,600	175,797	60,666	28,161	675	598	69,943	57,997	11,638	308	34
Other items	23,872	73	23,945		21,945				2,000	19,859	18,200		1,659	83
Total	674,063	70,093	744,156	647,299	637,963	327,395	80,568	29,719	25,625	313,403	255,187	43,727	14,489	42

For the notes to this table refer to the following page.

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Business review Risk and balance sheet management

Capital management* continued
RWA density continued

	EAD							
	EAD post CRM (1)							EAD post CRM RWA density
	Non-CCR	CCR (2)	Total	Drawn balance	Undrawn	Off-balance sheet	RWAs	(3)
2012	£m	£m	£m	£m	£m	£m	£m	%
Sovereign								
Central banks	78,154	13,242	91,396	88,724	65,168	—	2,977	3
Central government	37,694	1,353	39,047	37,752	1,298	10	4,190	11
Other sovereign	7,151	2,675	9,826	9,679	4,656	75	1,657	17
Total sovereign	122,999	17,270	140,269	136,155	71,122	85	8,824	6
Financial institutions (FI)								
Banks	26,887	37,382	64,269	61,624	43,078	5,558	21,669	34
Other FI	42,726	31,488	74,214	58,294	20,359	3,265	25,361	34
SPVs (4)	32,531	7,768	40,299	33,944	6,280	12	12,893	32
Total financial institutions	102,144	76,638	178,782	153,862	69,717	8,835	59,923	34
Corporates								
Property								
- Western Europe								
- UK	57,017	5,460	62,477	57,168	10,953	867	40,366	65
- Ireland	10,943	220	11,163	11,218	393	86	5,624	50
- Other	11,117	1,718	12,835	12,024	3,427	1,234	11,729	91
- US	8,021	391	8,412	6,605	3,527	458	7,633	91
- RoW	5,092	1,100	6,192	5,096	1,254	749	4,438	72
Total property	92,190	8,889	101,079	92,111	19,554	3,394	69,790	69
Natural resources	30,651	4,704	35,355	21,690	38,319	5,609	20,349	58
Transport	36,145	5,023	41,168	34,557	14,384	3,381	26,492	64
Manufacturing	32,458	1,690	34,148	25,941	30,483	4,270	23,733	70
Retail and leisure	33,569	2,042	35,611	30,387	16,669	1,903	27,511	77
Services	30,334	2,033	32,367	26,193	9,967	1,957	25,326	78
TMT (5)	15,716	2,518	18,234	158,576	15,561	1,926	13,622	75
Total corporates	271,063	26,899	297,962	389,455	144,937	22,440	206,823	69
Personal								
Mortgages								
- Western Europe								
- UK	117,709	—	117,709	108,581	9,423	—	18,206	15
- Ireland	17,258	—	17,258	16,939	45	—	16,929	98
- Other	763	—	763	742	20	—	250	33
- US	21,716	—	21,716	21,614	10,587	—	11,289	52
- RoW	761	—	761	724	37	—	221	29
Total mortgages	158,207	—	158,207	148,600	20,112	—	46,895	30
Other personal	50,291	22	50,313	32,141	40,435	146	28,127	56

Total personal	208,498	22	208,520	180,741	60,547	146	75,022	36
Other items	26,670	73	26,743				20,496	77
Total	731,374	120,902	852,276	860,213	346,323	31,506	371,088	44

Notes:
(1) CRM: Credit risk mitigation.
(2) CCR: Counterparty credit risk.
(3) RWA density represents RWAs as a percentage of EAD.
(4) SPVs: Special purpose vehicles.
(5) TMT: Telecoms, media and technology.

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Business review Risk and balance sheet management

Liquidity and funding risk

Business review Risk and balance sheet management

Liquidity and funding risk

Definition

Liquidity and funding risk is the risk that the Group is unable to meet its financial obligations, including financing wholesale maturities or customer deposit withdrawals, as and when they fall due.

The risk arises through the maturity transformation role that banks perform. It is dependent on company specific factors such as maturity profile, composition of sources and uses of funding, the quality and size of the liquidity portfolio as well as broader market factors, such as wholesale market conditions alongside depositor and investor behaviour.

Overview

- During 2013 the Group's deposit surplus continued to build and liquidity reserves were maintained at strong levels, further strengthening the balance sheet. This allowed the Group to easily absorb the minimal outflows following the announcement of the S&P credit rating downgrade (A-/A-2 from A/A-1, with a negative outlook) in November 2013.

- Following the continued success of the Group's Non-Core run-down and the reduction in the size of the Markets business, the Group's loan:deposit ratio improved by 600 basis points in the year to 94%. In response, the Group has been actively managing down excess cash, through liability management exercises and deposit re-pricing.

- The Group's credit profile improved significantly during the year, evidenced by the narrowing of the credit spreads. The spread of the most recent subordinated debt issue in December 2013 was 125 basis points lower than a comparable issuance in 2012.

- Continued reduction in the utilisation of wholesale funding and improvements in the characteristics and behavioural properties of the deposit base. Short-term wholesale funding excluding derivative collateral (STWF) reduced by 22% in the year to £32.4 billion, covered more than four times by the liquidity portfolio and the ratio of customer deposits to total funding improved to 75% from 70%.

- Continued enablement of new unencumbered assets as pre-positioned collateral for various central bank liquidity facilities.

Liquidity risk

Policy, framework and governance

The Group's liquidity policy reflects internal appetite, best market practice and complies with prevailing regulatory structures. These policies are designed to address four broad issues which ensure that:

- The Group's main legal entities maintain adequate liquid resources at all times to meet liabilities as they fall due.

- The Group maintains an adequate liquid asset portfolio appropriate to the business activities of the Group and its risk profile.

- The Group has in place robust strategies, policies, systems, and procedures for identifying, measuring, monitoring and managing liquidity risk.

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The Group has a comprehensive liquidity risk management framework in place to ensure the Group maintains an appropriate level of financial resources to meet its financial obligations as and when they fall due.

The risk management framework identifies the sources of liquidity risk and the steps the Group can take when these risks exceed certain actively monitored limits. These actions include when and how to use the Group's liquidity reserves and what other adjustments to the Group's balance sheet should be undertaken to manage these risks within the Group's risk appetite.

The Group's appetite for liquidity risk is set by the Board as a percentage of the Individual Liquidity Adequacy Assessment (ILAA) stressed outflows and then managed on a daily basis by various functions within the business with liquidity risk controlled at legal entity, country, regional and divisional levels.

In setting risk limits the Board takes into account the nature of the Group's various activities, the Group's overall risk appetite, market best practice and regulatory compliance.

The Group Asset and Liability Management Committee (GALCO) sets and reviews the liquidity risk management framework and limits within the risk appetite set by the Group Board. GALCO oversees the implementation of liquidity management across the Group. Each significant legal entity has a nominated Legal Entity Liquidity Risk Owner who is responsible for managing the liquidity risk for their legal entity. Group Treasury conducts the review, challenge and reporting of the Group's liquidity performance, while GALCO's management of liquidity risk is overseen by the Executive Risk Forum, Executive Committee and the Group Board.

Liquidity risk continued
Regulatory oversight*
The Group operates in multiple jurisdictions and is subject to a number of regulatory regimes.

The Group's principal regulator, the PRA, has a comprehensive set of liquidity policies, the cornerstone of which is Policy Statement (PS) 09/16. In order to comply with the PRA regulatory process, the Group:

- At least annually, completes and keeps updated an ILAA;

- Undertakes the Focused Liquidity Review process which is a comprehensive review of the Group's ILAA, liquidity policies and operational capacity and capability. This in turn leads to the Group and the PRA agreeing the parameters of Group's Individual Liquidity Guidance (ILG) which influences the overall size of the Group's liquidity portfolio.

In addition, the Group's US operations meet liquidity requirements set out by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Financial Industry Regulatory Authority. In the Netherlands, RBS N.V. is subject to the De Nederlandsche Bank liquidity oversight regime. In the Republic of Ireland, Ulster Bank Ireland Limited is subject to oversight from the Central Bank of Ireland.

In January 2013, the Basel Committee on Banking Supervision (BCBS) issued its revised draft guidance for calculating the liquidity coverage ratio (LCR), which is currently expected to come into force from 1 January 2015 on a phased basis. Pending the finalisation of the definitions, the Group monitors the LCR and the net stable funding ratio (NSFR) in its internal reporting framework based on its interpretation and expectation of the final rules. On this basis, as of 31 December 2013, the Group's LCR was 102% and the NSFR 122%.

At present there is a broad range of interpretations on how to calculate both the NSFR and the LCR due to the lack of commonly agreed technical standards. The Group continues to assess the impact of these consultations and actively communicates with regulators and industry groups. Assumptions will be refined as regulatory interpretations evolve.

Under the EU Capital Requirements Regulation to implement the recommended guidance of Basel 3, the European Banking Authority (EBA) is tasked with issuing a set of technical standards for implementing the LCR within the EU, to be ratified by the European Commission before 30 June 2014. The LCR metric will come into effect as a minimum standard from 1 January 2015.

The PRA has issued a statement proposing to retain the existing ILG framework until 31 December 2014, whilst the EBA's implementation of the LCR is finalised.

Several regulatory regimes outside the EU where the Group operates have also published consultation papers with guidance for implementation of the LCR, including the Joint Banking Supervisors of the US. We anticipate further consultations for LCR standards to be published across other jurisdictions in which the Group operates during the course of 2014. Additionally, the BCBS has issued a proposal for revising the guidance on NSFR, expected to be finalised in 2014.

Measurement and monitoring
In implementing the Group's liquidity risk management framework, a suite of tools are used to monitor, limit and stress test the risks within the balance sheet. The limits control the amount and composition of funding sources, asset and liability mismatches and funding concentrations, in addition to the level of liquidity risk.

To foster appropriate pricing behaviour, decision making and balance sheet composition Group Treasury uses transfer pricing of liquidity and funding costs, limits and parameters. This ensures liquidity and funding risk is reflected in the measurement of divisional business performance and ensures divisions are being correctly incentivised to source the most appropriate mix of funding.

The Board's determination and quantification of the appetite for liquidity risk is primarily determined by reference to the ILAA which includes a comparison of the size of liquidity portfolio to an assessment of stressed outflows. The ILAA also informs the Board and PRA of the Group's liquidity risks, their mitigation and about the current and future liquidity profile.

Within the liquidity portfolio the Group holds cash at central banks, high quality government securities and collateral eligible for use in central bank operations, such as the Bank of England's Discount Window Facility.

In determining what assets should be held within the liquidity portfolio, the liquidity risk management framework dictates minimum internal quality criteria, level of currency diversification and maturity mix. The liquidity value of an asset is generally determined by reference to the haircut that would be applied by a central bank operation or in a private repurchase agreement.

The Group actively monitors a range of market-wide and firm-specific early warning indicators of emerging liquidity stresses. Indicators include such areas as customer deposit outflows, market funding costs and movements in the Group's credit default swap premiums. Early warning indicators and regulatory metrics are reported daily to senior management, including the CFO and Group Treasurer.

Liquidity risks are reviewed daily at a significant legal entity level and performance reported at least monthly to legal entity, divisional and Group Asset and Liability Management Committees. Any breach of internal metric limits will set in motion a series of actions and escalations that could lead to activation of the Group's Contingency Funding Plan.

In November 2013, the Group's credit rating was downgraded by Standard & Poor's. Prior to this event, the Group undertook an intensive internal review of the magnitude of a rating downgrade on customer and counterparty behaviours and these included stress testing and scenario modelling. This analysis was also shared with the PRA. Following the downgrade by Standard & Poor's, there was minimal impact on customer or counterparty behaviour, the primary reason for deposit withdrawals was due to contractual downgrade triggers or the rating no longer meeting the customer or counterparty's investment requirements.

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Liquidity risk continued

Stress testing and contingency planning*

Liquidity stress tests apply scenario-based behavioural and contractual assumptions to cash inflows and outflows to assess the level of liquidity reserves required under a particular scenario.

A stress event can occur when either firm-specific or market-wide factors or a combination of both lead to depositors and investors to withdraw or not to renew funding on maturity. This could be caused by many factors including fears over the viability of the firm. Additionally, liquidity stress can be brought on by customers choosing to draw down on loan agreements and facilities.

Simulated liquidity stress testing is performed at least quarterly for each division as well as the major operating subsidiaries in order to evaluate the strength of the Group's liquidity risk management.

Stress tests are designed to examine the impact of a variety of firm-specific and market-wide scenarios on the future adequacy of the Group's liquidity reserves. Stress test scenarios are designed to take into account the Group's experiences during the financial crisis, recent market conditions and events. These scenarios can be run at any time in response to the emergence of firm-specific or market-wide risks that could have a material impact on the Group's liquidity position. In the past these have included credit rating changes and political and economic conditions changing in particular countries.

In determining the adequacy of the Group's liquidity resources the Group focuses on the outflows it anticipates as a result of any stress scenario occurring. These outflows are measured over certain time periods which extend from two weeks to three months. The Group is expected to be able to withstand these stressed outflows through its own resources (primarily through the use of the liquidity portfolio) without having to resort to extraordinary central bank or governmental assistance.

The Group's liquidity risk appetite is measured by reference to the liquidity portfolio as a percentage of stressed contractual and behavioural outflows under the worst of three severe stress scenarios, as prescribed by the PRA. These are a market-wide stress, an idiosyncratic stress and a combination of both. At 31 December 2013, the Group's liquidity portfolio was 145% of the worst case stress requirements.

Key liquidity risk stress testing assumptions

- Net wholesale funding - Outflows at contractual maturity of wholesale funding, with no rollover/new issuance, prime brokerage, 100% loss of excess client derivative margin and 100% loss of excess client cash.

- Secured financing and increased haircuts - Loss of secured funding capacity at contractual maturity date and incremental haircut widening, depending upon collateral type.

- Retail and commercial bank deposits - Substantial outflows as the Group could be seen as a greater credit risk than competitors.

- Intra-day cash flows - Liquid collateral held against intra-day requirement at clearing and payment systems is regarded as encumbered with no liquidity value assumed. Liquid collateral is held against withdrawal of unsecured intra-day lines provided by third parties.

- Intra-group commitments and support - Risk of cash within subsidiaries becoming unavailable to the wider Group and contingent calls for funding on Group Treasury from subsidiaries and affiliates.

- Funding concentrations - Additional outflows recognised against concentration of providers of wholesale secured financing.

- Off-balance sheet activities - Collateral outflows due to market movements, and all collateral owed by the Group to counterparties but not yet called; anticipated increase in firm's derivative initial margin requirement in stress scenarios; collateral outflows contingent upon a multi-notch credit rating downgrade of Group firms; drawdown on committed facilities provided to corporates, based on counterparty type, creditworthiness and facility type; and drawdown on retail commitments.

- Franchise viability - Group liquidity stress testing includes additional liquidity in order to meet outflows that are non-contractual in nature, but are necessary in order to support valuable franchise businesses.

- Management action - Unencumbered marketable assets that are held outside of the Core liquidity portfolio and are of verifiable liquidity value to the firm, are assumed to be monetised (subject to haircut/valuation adjustment).

The Group has a Contingency Funding Plan (CFP), which is updated at least annually and as the balance sheet evolves and forms the basis of analysis and actions to remediate adverse events as and if they arise. The CFP provides a detailed description of the availability, size and timing of all sources of contingent liquidity available to the 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 and specifies roles and responsibilities for the effective implementation of the CFP.

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Business review Risk and balance sheet management

Liquidity risk continued
Liquidity reserves
Liquidity risks are mitigated by the Group's centrally managed liquidity portfolio. The size of the portfolio is determined under the Group's liquidity risk management framework with reference to the Group's risk appetite.

The majority of the portfolio is centrally managed by Group Treasury, ring-fenced from the Markets trading book, and is the ultimate responsibility of the Group Treasurer. This portfolio is held in the PRA regulated UK Defined Liquidity Group (UK DLG) comprising the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company.

Certain of the Group's significant operating subsidiaries - RBS N.V., RBS Citizens Financial Group, Inc. and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations but differ from PRA rules. These portfolios are the responsibility of the local Treasurer who reports to the Group Treasurer.

The UK DLG liquidity portfolio accounted for c.88% of the Group's total liquidity portfolio, this portion is available to meet liquidity needs as they arise across the Group. The remaining liquidity reserves are held locally within non-UK bank subsidiaries, the majority of this portion is restricted by regulatory requirements and therefore assumed to be restricted and only be available for use locally.

Separately from the liquidity portfolio, the Group holds high quality assets to meet payment systems collateral requirements, these assets are not freely available to other areas of the Group.

The Group categorises its liquidity portfolio, including its locally managed liquidity portfolios, into primary and secondary liquid assets.

Primary liquid assets generally comprise eligible liquid assets, such as cash and balances at central banks, treasury bills and other high quality government and US agency bonds.

Secondary liquid assets comprise other assets that are eligible as collateral for local central bank liquidity facilities but do not meet the core local regulatory definition. These assets include own-issued securitisations or whole loans that are retained on balance sheet and pre-positioned with a central bank so that they may be converted into additional sources of liquidity at very short notice.

The composition of the liquidity portfolio is influenced by quality of counterparty, maturity mix and currency mix. The PRA rules dictate certain minimum quality standards for the UK DLG liquidity portfolio. The liquidity value of the portfolio is determined with reference to current market prices and the haircuts necessary to generate cash from the asset.

The Group in consultation with the PRA and subject to the requirements of the PRA's ILG can change the composition of its liquidity portfolio. The change in composition may relate to market specific factors, changes in internal liquidity risk mix or regulatory guidance.

Liquidity metrics*
The table below sets out the key liquidity and related metrics monitored by the Group.

	2013	2012

	%	%
Stressed outflow coverage (1)	145	128
Liquidity coverage ratio (LCR) (2)	102	>100
Net stable funding ratio (NSFR) (2)	122	117

Notes:

(1) The Group's liquidity risk appetite is based on the internal Individual Liquidity Adequacy Assessment which is measured by reference to the liquidity portfolio as a percentage of stressed outflows under the worst of three severe stress scenarios of a market-wide stress, an idiosyncratic stress and a combination of both. Liquidity risk adequacy is determined by surplus of liquid assets over three months stressed outflows under the worst case stresses. This assessment is performed in accordance with PRA guidance.

(2) In January 2013, the Basel Committee on Banking Supervision issued its revised draft guidance for calculating LCR which is currently expected to come into effect from January 2015 on a phased basis. Pending the finalisation of the technical standards, the Group monitors the LCR and NSFR based on its interpretations of the expected final rules.

*unaudited

Business review Risk and balance sheet management

Liquidity risk continued

Liquidity portfolio

The table below analyses the Group's liquidity portfolio by product, liquidity value and carrying value. Liquidity value is lower than carrying value as it is stated after the discounts applied by the Bank of England and other central banks to instruments, within the secondary liquidity portfolio, eligible for discounting.

	Liquidity value								
	2013					2012		2011	
	UK DLG (1)	CFG (1)	Other	Total	Average	Total	Average	Total	Average
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	71,121	824	2,417	74,362	80,933	70,109	81,768	69,932	74,711
Central and local government bonds									
AAA rated governments	3,320	—	—	3,320	5,149	9,885	18,832	29,632	37,947
AA- to AA+ rated governments and US agencies	5,822	6,369	96	12,287	12,423	9,621	9,300	14,102	3,074
governments rated below AA	—	—	—	—	151	206	596	955	925
local government	—	—	—	—	148	979	2,244	4,302	4,779
	9,142	6,369	96	15,607	17,871	20,691	30,972	48,991	46,725
Treasury bills	—	—	—	—	395	750	202	—	5,937
Primary liquidity	80,263	7,193	2,513	89,969	99,199	91,550	112,942	118,923	127,373
Secondary liquidity (2)	48,718	4,968	2,411	56,097	56,589	55,619	41,978	36,407	34,075
Total liquidity portfolio	128,981	12,161	4,924	146,066	155,788	147,169	154,920	155,330	161,448
Carrying value	159,743	17,520	6,970	184,233		187,942		193,495	

The table below shows the currency split of the liquidity portfolio.

	GBP	USD	EUR	Other	Total
Total liquidity portfolio	£m	£m	£m	£m	£m
2013	100,849	33,365	10,364	1,488	146,066
2012	84,570	35,106	26,662	831	147,169
2011	48,839	54,145	50,275	2,071	155,330

Notes:

(1) The PRA regulated UK Defined Liquidity Group (UK DLG) comprises the Group's five UK banks: The Royal Bank of Scotland plc, National Westminster Bank Plc, Ulster Bank Limited, Coutts & Company and Adam & Company plc. In addition, certain of the Group's significant operating subsidiaries - RBS N.V., RBS Citizens Financial Group, Inc. (CFG) and Ulster Bank Ireland Limited - hold locally managed portfolios of liquid assets that comply with local regulations that may differ from PRA rules.

(2) Includes assets eligible for discounting at the Bank of England and other central banks.

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Liquidity risk continued

Net stable funding ratio (NSFR)*

The table below shows the composition of the Group's NSFR, based on the current interpretation of the expected final rules. The Group's NSFR may change over time in line with regulatory developments and related interpretations.

	2013		2012		2011		
		ASF/RSF (1)		ASF/RSF (1)		ASF/RSF (1)	Weighting
	£bn	£bn	£bn	£bn	£bn	£bn	%
Equity	59	59	70	70	76	76	100
Wholesale funding > 1 year	76	76	109	109	124	124	100
Wholesale funding < 1 year	51	—	70	—	134	—	—
Derivatives	286	—	434	—	524	—	—
Repurchase agreements	85	—	132	—	129	—	—
Deposits							
- retail and SME - more stable	196	176	203	183	227	204	90
- retail and SME - less stable	66	53	66	53	31	25	80
- other	156	78	164	82	179	89	50
Other (2)	53	—	64	—	83	—	—
Total liabilities and equity	1,028	442	1,312	497	1,507	518	
Cash	83	—	79	—	79	—	—
Inter-bank lending	28	—	29	—	44	—	—
Debt securities > 1 year							
- governments AAA to AA-	47	2	64	3	77	4	5
- other eligible bonds	31	6	48	10	73	15	20
- other bonds	16	16	19	19	14	14	100
Debt securities < 1 year	20	—	26	—	45	—	—
Derivatives	288	—	442	—	530	—	—
Reverse repurchase agreements	76	—	105	—	101	—	—
Customer loans and advances > 1 year							
- residential mortgages	135	88	145	94	145	94	65
- other	114	114	136	136	173	173	100
Customer loans and advances < 1 year							
- retail loans	18	15	18	15	19	16	85
- other	126	63	131	66	137	69	50
Other (3)	46	46	70	70	70	70	100
Total assets	1,028	350	1,312	413	1,507	455	
Undrawn commitments	213	11	216	11	240	12	5
Total assets and undrawn commitments	1,241	361	1,528	424	1,747	467	
Net stable funding ratio		122%		117%		111%	

Notes:

(1) Available stable funding and required stable funding.

(2)	Deferred tax and other liabilities.
(3)	Prepayments, accrued income, deferred tax, settlement balances and other assets.

Key point

- The NSFR has improved by 500 basis points to 122% in the year. The required stable funding fell by £63 billion mainly due to the £31 billion decrease in customer lending reflecting balance sheet reduction, business disposals and a £24 billion reduction in other assets, principally equity shares reduction in Markets and lower disposal groups. This was mostly offset by a £55 billion reduction in available stable funding primarily due to a £33 billion planned reduction in term wholesale funding and £11 billion in customer deposit outflow.

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Funding risk

Funding sources

The Group's primary funding source is its customer deposit base, primarily built through its retail and commercial franchises in the UK, Ireland and the US. These deposits form a stable base which fully funds the Group's customer lending activities.

Complementary to its deposit funding, the Group also accesses various wholesale markets for funding, on both a public and private basis. These include long-term secured and unsecured debt, short-term money markets and repurchase agreements. The Group has set policies for the prudent use of wholesale funding, as part of its wider liquidity policies.

Maintaining access to global capital markets provides the Group's funding base with diversity. Over time the Group's wholesale funding mix has been diversified by currency, geography, maturity and type. The Group accesses the wholesale funding markets directly or through its main operating subsidiaries via established funding programmes. The use of different entities to access the market from time to time allows the Group to further diversify its funding mix and in certain limited circumstances demonstrate to regulators that specific operating subsidiaries enjoy market access in their own right.

The 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 the Group's broader liquidity management and funding strategy. Overall usage and repayment of available central bank facilities will fit within the Group's overall liquidity risk appetite and concentration limits.

During 2013, the Group repaid €8.5 billion of the original €10 billion borrowed under the European Central Bank's Long Term Refinancing Operation. The remaining balance is used to fund certain of the Group's Eurozone banking subsidiaries and the usage of this facility will be evaluated on an ongoing basis. The Group has not drawn down any additional funds under the Bank of England's Funding for Lending Scheme during the year and has repaid the initial drawing of £750 million in order to manage its excess cash position. The Group remains committed to supporting the objectives of the Funding for Lending scheme.

Analysis

Funding sources

The Group's balance sheet composition is a function of the broad array of product offerings and diverse 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 the liquidity profile in the normal business environment, while ensuring adequate coverage of all cash requirements under extreme stress conditions.

As set out below the Group's asset and liability types broadly match. Customer deposits provide more funding than customer loans absorb; repurchase agreements are largely covered by reverse repurchase agreements; interbank lending and funding largely match each other and this gap has narrowed over the past five years; and derivative assets are largely matched against derivative liabilities.

The table below shows the Group's sources and uses of funding.

	2013		
	Liabilities	Assets	
	£bn	£bn	
Customer deposits (1)	407	373	Customer loans and advances (1)
Bank deposits (short-term only) (1)	14	18	Loan and advances to banks (1)
Trading liabilities (2)	67	93	Trading assets (2)
Other liabilities and equity (3)	100	90	Other assets (3)
Repurchase agreements	85	76	Reverse repurchase agreements
Term wholesale funding (1)	69	90	Primary liquidity portfolio
Funded balance sheet	742	740	Funded balance sheet
Derivatives	286	288	Derivatives
	1,028	1,028	

Notes:

(1) Excludes held for trading.

(2) Financial instruments classified as held-for-trading (HFT) excluding security financing transactions and derivatives.

(3) Includes non-HFT financial instruments and non-financial assets/liabilities.

Funding risk continued
Analysis continued
Wholesale funding
The table below summarises funding metrics.

	Short-term wholesale funding (1)		Total wholesale funding		Net inter-bank funding (2)		
	Excluding derivative collateral	Including derivative collateral	Excluding derivative collateral	Including derivative collateral	Deposits	Loans (3)	Net inter-bank funding
	£bn	£bn	£bn	£bn	£bn	£bn	£bn
2013	32.4	51.5	108.1	127.2	16.2	(17.3)	(1.1)
2012	41.6	70.2	150.4	179.0	28.5	(18.6)	9.9
2011	102.4	134.2	226.2	258.1	37.3	(24.3)	13.0

Notes:
(1) Short-term wholesale balances denote those with a residual maturity of less than one year and include longer-term issuances.
(2) Excludes derivative cash collateral.
(3) Primarily short-term balances.

The table below shows the Group's principal funding sources excluding repurchase agreements.

	2013			2012			2011		
	Less than 1 year	More than 1 year	Total	Less than 1 year	More than 1 year	Total	Less than 1 year	More than 1 year	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Deposits by banks									
derivative cash collateral	19,086	—	19,086	28,585	—	28,585	31,807	—	31,807
other deposits	14,553	1,690	16,243	18,938	9,551	28,489	32,847	4,460	37,307
	33,639	1,690	35,329	47,523	9,551	57,074	64,654	4,460	69,114
Debt securities in issue									
conduit asset-backed commercial paper (ABCP)	—	—	—	—	—	—	11,164	—	11,164
other commercial paper (CP)	1,583	—	1,583	2,873	—	2,873	5,310	—	5,310
certificates of deposit (CDs)	2,212	65	2,277	2,605	391	2,996	16,086	281	16,367
medium-term notes (MTNs)	10,385	36,779	47,164	13,019	53,584	66,603	36,302	69,407	105,709
covered bonds	1,853	7,188	9,041	1,038	9,101	10,139	—	9,107	9,107
securitisations	514	7,240	7,754	761	11,220	11,981	27	14,937	14,964
	16,547	51,272	67,819	20,296	74,296	94,592	68,889	93,732	162,621
Subordinated liabilities	1,350	22,662	24,012	2,351	24,951	27,302	624	25,695	26,319

Notes issued	17,897	73,934	91,831	22,647	99,247	121,894	69,513	119,427	188,940
Wholesale funding	51,536	75,624	127,160	70,170	108,798	178,968	134,167	123,887	258,054
Customer deposits									
derivative cash collateral	7,082	—	7,082	7,949	—	7,949	9,242	—	9,242
other deposits	395,520	15,067	410,587	400,012	26,031	426,043	412,931	14,580	427,511
Total customer deposits	402,602	15,067	417,669	407,961	26,031	433,992	422,173	14,580	436,753
Total funding	454,138	90,691	544,829	478,131	134,829	612,960	556,340	138,467	694,807

Key points

- Wholesale funding reduced by nearly 29% in the year to £127 billion principally reflecting strategic downsizing in Markets.

- Short-term wholesale funding has decreased by £9.2 billion to £32.4 billion reflecting the reduced funding requirement and ongoing liability management.

*unaudited

Business review Risk and balance sheet management

Funding risk continued
Analysis continued
Total funding by currency

2013	GBP £m	USD £m	EUR £m	Other £m	Total £m
Deposits by banks	7,418	8,337	17,004	2,570	35,329
Debt securities in issue					
commercial paper	4	897	682	—	1,583
certificates of deposit	336	1,411	476	54	2,277
medium-term notes	6,353	11,068	23,218	6,525	47,164
covered bonds	984	—	8,057	—	9,041
securitisations	1,897	2,748	3,109	—	7,754
Subordinated liabilities	1,857	10,502	8,984	2,669	24,012
Wholesale funding	18,849	34,963	61,530	11,818	127,160
% of wholesale funding	15%	28%	48%	9%	100%
Customer deposits	272,304	86,727	49,116	9,522	417,669
Total funding	291,153	121,690	110,646	21,340	544,829
% of total funding	54%	22%	20%	4%	100%
2012					
Wholesale funding	22,688	41,563	93,700	21,017	178,968
% of wholesale funding	13%	23%	52%	12%	100%
Total funding	297,274	136,490	146,203	32,993	612,960
% of total funding	49%	22%	24%	5%	100%

Key point

- The proportion of funding held in euros decreased in the year from 24% to 20% reflecting the reduction in euro denominated assets in Non-Core and Markets.

Notes issued

The table below shows the Group's debt securities in issue and subordinated liabilities by residual maturity.

	Debt securities in issue								
2013	Conduit ABCP £m	Other CP and CDs £m	MTNs £m	Covered bonds £m	Securitisations £m	Total £m	Subordinated liabilities £m	Total notes in issue £m	Total notes in issue %
Less than 1 year	—	3,795	10,385	1,853	514	16,547	1,350	17,897	19
1-3 years	—	61	14,920	3,621	—	18,602	3,944	22,546	25
3-5 years	—	—	6,497	867	—	7,364	4,209	11,573	13
More than 5 years	—	4	15,362	2,700	7,240	25,306	14,509	39,815	43
	—	3,860	47,164	9,041	7,754	67,819	24,012	91,831	100

2012									
Less than 1 year	—	5,478	13,019	1,038	761	20,296	2,351	22,647	18
1-3 years	—	385	20,267	2,948	540	24,140	7,252	31,392	26
3-5 years	—	1	13,374	2,380	—	15,755	756	16,511	14
More than 5 years	—	5	19,943	3,773	10,680	34,401	16,943	51,344	42
	—	5,869	66,603	10,139	11,981	94,592	27,302	121,894	100
2011									
Less than 1 year	11,164	21,396	36,302	—	27	68,889	624	69,513	37
1-3 years	—	278	26,595	2,760	479	30,112	3,338	33,450	18
3-5 years	—	2	16,627	3,673	—	20,302	7,232	27,534	14
More than 5 years	—	1	26,185	2,674	14,458	43,318	15,125	58,443	31
	11,164	21,677	105,709	9,107	14,964	162,621	26,319	188,940	100

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Business review Risk and balance sheet management

Funding risk continued
Analysis continued
Deposits and repos
The table below shows the composition of the Group's deposits and repos.

	2013		2012		2011	
	Deposits £m	Repos £m	Deposits £m	Repos £m	Deposits £m	Repos £m
Financial institutions						
- central and other banks	35,329	28,650	57,074	44,332	69,114	39,691
- other financial institutions	53,607	52,945	64,237	86,968	66,009	86,032
Personal and corporate deposits	364,062	3,539	369,755	1,072	370,744	2,780
	452,998	85,134	491,066	132,372	505,867	128,503

£161 billion (or 39%) of the customer deposits included above are insured through the UK Financial Services Compensation Scheme, US Federal Deposit Insurance Corporation scheme and other similar schemes. Of the personal and corporate deposits above, 53% relate to personal customers.

Firm financing*
The Group has access to the short-term money markets to supplement deposit and wholesale funding. The Group's reverse repos, mainly within Markets, are generally used to fund repos or to cover short positions. In addition, repos are used to fund a small proportion of Markets' trading assets and by Group Treasury as part of the liquidity portfolio management.

The liquidity risk the Group is exposed to through security financing transactions is significantly lower than in relation to unsecured funding. The Group limits any exposure by setting limits and monitoring any mismatch of quality, maturity or currency. The exposure is also monitored in the context of the available liquid assets.

The following table shows the Groups gross repos by quality and maturity.

2013	Less than 1 month £bn	More than 1 month £bn	Total £bn
AA- and above	69.5	21.6	91.1
Other	27.6	7.1	34.7
Total	97.1	28.7	125.8

Key points
- 72% of the Group's repo balance related to AA- or above collateral reducing the exposure to re-financing risk.
- Of the £125.8 billion gross repos, £49.6 billion related to firm financing.

*unaudited

Business review Risk and balance sheet management

Funding risk continued
Divisional loan:deposit ratios and funding surplus
The table below shows divisional loans, deposits, loan:deposit ratios and customer funding surplus.

	2013				2012		2011	
	Loans (1)	Deposits (2)	Loan:deposit ratio	Funding surplus/(gap)	Loan:deposit ratio	Funding (gap)/surplus	Loan:deposit ratio	Funding (gap)/surplus
	£m	£m	%	£m	%	£m	%	£m
UK Retail	111,046	114,889	97	3,843	103	(3,337)	106	(6,105)
UK Corporate	99,714	124,742	80	25,028	82	22,477	86	17,641
Wealth	16,644	37,173	45	20,529	44	21,945	44	21,330
International Banking	35,668	39,278	91	3,610	86	6,672	103	(1,366)
Ulster Bank	26,068	21,651	120	(4,417)	130	(6,683)	143	(9,489)
US Retail & Commercial	50,279	55,118	91	4,839	86	8,178	85	8,871
Conduits (3)	—	—	—	—	—	(2,458)	—	(10,504)
Retail & Commercial	339,419	392,851	86	53,432	88	46,794	95	20,378
Markets	25,231	21,545	117	(3,686)	112	(3,243)	85	5,522
Other	5,060	1,085	nm	(3,975)	64	1,217	nm	2,464
Core	369,710	415,481	89	45,771	90	44,768	93	28,364
Non-Core	22,880	2,188	nm	(20,692)	nm	(41,846)	nm	(64,235)
Direct Line Group	—	—	—	—	—	(881)	—	(893)
Group	392,590	417,669	94	25,079	100	2,041	108	(36,764)

nm = not meaningful

Notes:
(1) Excludes reverse repurchase agreements and net of impairment provisions.
(2) Excludes repurchase agreements.
(3) All conduits relate to International Banking and have been extracted and shown separately as they were funded by commercial paper issuance until the end of the third quarter of 2012.

Key point
- The loan:deposit ratio improved by 600 basis points to 94% with the funding surplus increasing to £25.1 billion from £2.0 billion at 31 December 2012. The improvement in Retail & Commercial funding surplus was £6.6 billion and Non-Core run-off resulted in £21.2 billion contraction of its funding gap.

Maturity analysis

The contractual maturity of balance sheet assets and liabilities reflects the maturity transformation role banks perform, lending long-term but obtaining funding predominantly through short-term liabilities such as customer deposits. In practice, the behavioural profiles of many liabilities exhibit greater stability and longer maturity than the contractual maturity. This is particularly true of many types of retail and corporate deposits which, despite being repayable on demand or at short notice, have demonstrated stable characteristics even in periods of acute stress such as those experienced in 2008.

Retail & Commercial*
The table below shows the behavioural and contractual maturity analysis of Retail & Commercial customer deposits.

2013	Less than 1 year £bn	1-5 years £bn	More than 5 years £bn	Total £bn
Contractual maturity	381	12	—	393
Behavioural maturity	124	220	49	393
2012				
Contractual maturity	380	20	1	401
Behavioural maturity	145	219	37	401

*unaudited

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Business review Risk and balance sheet management

Funding risk continued
Maturity analysis continued
Contractual maturity
The following table shows the residual maturity of financial instruments, based on contractual date of maturity. Held-for-trading (HFT) assets and liabilities have been excluded from the maturity analysis in view of their short-term nature and are shown in total in the table below. Hedging derivatives are included within the relevant maturity bands.

	Other than held-for-trading (HFT)										
2013	Less than 1 month £m	1-3 months £m	3-6 months £m	6 months -1 year £m	Subtotal £m	1-3 years £m	3-5 years £m	More than 5 years £m	Total excluding HFT £m	HFT £m	Total £m
Cash and balances at central banks	82,661	—	—	—	82,661	—	—	—	82,661	—	82,661
Bank reverse repos	652	110	—	—	762	—	—	—	762	25,795	26,557
Customer reverse repos	—	—	—	—	—	—	—	—	—	49,897	49,897
Loans to banks	11,831	3,171	1,552	443	16,997	69	13	546	17,625	9,952	27,577
Loans to customers											
- Personal	7,776	8,942	4,141	7,108	27,967	24,008	20,107	100,664	172,746	239	172,985
- Corporate	20,310	11,741	13,175	16,970	62,196	43,207	34,227	38,746	178,376	5,561	183,937
- Financial Institutions	6,072	1,435	2,264	2,346	12,117	5,173	1,915	3,093	22,298	13,370	35,668
Debt securities	1,608	954	1,787	2,324	6,673	7,425	8,782	34,161	57,041	56,582	113,623
Equity shares	—	—	—	—	—	—	—	1,612	1,612	7,199	8,811
Settlement balances	5,591	—	—	—	5,591	—	—	—	5,591	—	5,591
Derivatives	546	—	—	1,282	1,828	2,148	427	129	4,532	283,508	288,040
Total financial assets	137,047	26,353	22,919	30,473	216,792	82,030	65,471	178,951	543,244	452,103	995,347
Bank repos	3,045	1,297	—	—	4,342	1,181	—	—	5,523	23,127	28,650
Customer repos	3,059	1,125	—	—	4,184	—	—	—	4,184	52,300	56,484
Deposits by banks	10,676	1,882	1,382	125	14,065	82	109	1,309	15,565	19,764	35,329
Customer accounts											
- Personal	160,261	10,370	5,562	7,262	183,455	6,789	1,449	20	191,713	—	191,713
- Corporate	158,138	4,458	2,369	1,476	166,441	2,690	728	681	170,540	1,809	172,349
- Financial Institutions	41,632	1,265	636	498	44,031	661	450	38	45,180	8,427	53,607
Debt securities in issue	2,383	3,221	2,667	6,844	15,115	15,729	6,388	22,027	59,259	8,560	67,819
Settlement balances	5,313	—	—	—	5,313	—	—	—	5,313	—	5,313
Short positions	—	—	—	—	—	—	—	—	—	28,022	28,022
Derivatives	1	130	271	—	402	933	1,190	1,703	4,228	281,299	285,527
Subordinated liabilities	16	124	150	1,060	1,350	3,944	4,078	14,640	24,012	—	24,012
Other liabilities	1,764	—	—	—	1,764	2	16	1	1,783	—	1,783

Total financial liabilities	386,288	23,872	13,037	17,265	440,462	32,011	14,408	40,419	527,300	423,308	950,608

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Business review Risk and balance sheet management

Funding risk continued
Maturity analysis continued

	Other than held-for-trading (HFT)										
2012	Less than 1 month £m	1-3 months £m	3-6 months £m	6 months -1 year £m	Subtotal £m	1-3 years £m	3-5 years £m	More than 5 years £m	Total excluding HFT £m	HFT £m	Total £m
Cash and balances at central banks	79,308	—	—	—	79,308	—	—	—	79,308	—	79,308
Bank reverse repos	1,302	87	—	—	1,389	—	—	—	1,389	33,394	34,783
Customer reverse repos	22	—	—	—	22	—	—	—	22	70,025	70,047
Loans to banks	14,519	1,879	1,005	206	17,609	269	35	102	18,015	13,265	31,280
Loans to customers											
- Personal	11,521	2,297	1,815	3,301	18,934	10,432	13,437	134,124	176,927	668	177,595
- Corporate	22,697	13,751	14,464	21,363	72,275	43,658	36,835	52,426	205,194	7,284	212,478
- Financial Institutions	6,665	2,276	2,990	2,713	14,644	4,413	2,658	3,274	24,989	16,889	41,878
Debt securities	2,206	1,869	1,279	1,676	7,030	11,847	17,929	49,478	86,284	78,340	164,624
Equity shares	—	—	—	—	—	—	—	1,908	1,908	13,329	15,237
Settlement balances	5,741	—	—	—	5,741	—	—	—	5,741	—	5,741
Derivatives	—	571	626	1,252	2,449	3,803	1,879	508	8,639	433,279	441,918
Other assets	72	28	32	106	238	31	38	617	924	—	924
Total financial assets	144,053	22,758	22,211	30,617	219,639	74,453	72,811	242,437	609,340	666,473	1,275,813
Bank repos	3,551	3,261	—	—	6,812	1,150	—	—	7,962	36,370	44,332
Customer repos	2,733	3,083	—	—	5,816	—	—	—	5,816	82,224	88,040
Deposits by banks	15,046	1,409	564	489	17,508	7,127	336	1,532	26,503	30,571	57,074
Customer accounts											
- Personal	150,310	6,846	5,904	11,466	174,526	11,936	2,267	93	188,822	431	189,253
- Corporate	162,472	5,264	2,196	3,017	172,949	5,935	1,182	1,202	181,268	2,393	183,661
- Financial Institutions	46,375	2,663	173	1,163	50,374	1,077	211	163	51,825	9,253	61,078
Debt securities in issue	2,248	2,639	7,996	6,263	19,146	21,220	12,038	31,309	83,713	10,879	94,592
Settlement balances	5,875	—	—	—	5,875	3	—	—	5,878	—	5,878
Short positions	—	—	—	—	—	—	—	—	—	27,591	27,591

Derivatives	—	310	251	501	1,062	1,790	1,262	1,682	5,796	428,544	434,340
Subordinated liabilities	231	184	1,352	620	2,387	7,070	862	16,983	27,302	—	27,302
Other liabilities	1,684	—	—	—	1,684	8	1	3	1,696	—	1,696
Total financial liabilities	390,525	25,659	18,436	23,519	458,139	57,316	18,159	52,967	586,581	628,256	1,214,837

Funding risk continued

Encumbrance

The 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.

From time to time the Group encumbers assets to serve as collateral to support certain wholesale funding initiatives. The three principal forms of encumbrance are own asset securitisations, covered bonds and securities repurchase agreements.

The Group categorises its assets into three broad groups; assets that are:

- already encumbered and used to support funding currently in place via own asset securitisations, covered bonds and securities repurchase agreements.

- 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.

- not currently encumbered. In this category, the Group has in place an enablement programme which seeks to identify assets which are capable of being encumbered and to identify the actions to facilitate such encumbrance whilst not impacting customer relationships or servicing.

The Group's encumbrance ratios are set out below.

	2013	2012	2011
Encumbrance ratios	%	%	%
Total	17	18	19
Excluding balances relating to derivative transactions	19	22	26
Excluding balances relating to derivative and securities financing transactions	11	13	19

Key points

- The Groups total encumbrance ratio dropped to 17%.

- 31% of the Group's residential mortgage portfolio was encumbered as at 31 December 2013.

- Unencumbered financial assets covered unsecured liabilities excluding derivatives.

- In addition to the £451.4 billion on-balance sheet assets available to support future funding and collateral requirements there is £12.7 billion net off-balance sheet collateral available from reverse repurchase and derivative collateral transactions.

Business review Risk and balance sheet management

Funding risk continued
Encumbrance continued
Balance sheet encumbrance

	Encumbered assets relating to:						Encumbered	Unencumbere		
	Debt securities in issue		Other secured liabilities			Total	assets	Readily realisable (2)		
	Securitisations and conduits	Covered bonds	Derivatives	Repos	Secured deposits	encumbered assets (1)	% of related assets	Liquidity portfolio	Other	Other realisable (3
2013	£bn	£bn	£bn	£bn	£bn	£bn	%	£bn	£bn	£bn
Cash and balances at central banks	—	—	—	—	—	—	—	74.3	8.4	
Loans and advances to banks	5.8	0.5	10.3	—	—	16.6	60	0.1	10.9	
Loans and advances to customers										
- UK residential mortgages	14.6	16.2	—	—	—	30.8	28	60.8	18.6	
- Irish residential mortgages	9.3	—	—	—	1.2	10.5	70	0.7	3.8	
- US residential mortgages	—	—	—	—	3.5	3.5	18	9.5	6.7	
- UK credit cards	3.4	—	—	—	—	3.4	52	—	3.1	
- UK personal loans	3.4	—	—	—	—	3.4	38	—	5.5	
- other	13.5	—	18.1	—	0.8	32.4	14	4.4	9.6	175.[illegible]
Reverse repurchase agreements and stock borrowing	—	—	—	—	—	—	—	—	—	
Debt securities	0.9	—	5.5	55.6	2.7	64.7	57	17.0	31.9	
Equity shares	—	—	0.5	5.3	—	5.8	66	—	3.0	
Settlement balances	—	—	—	—	—	—	—	—	—	
Derivatives	—	—	—	—	—	—	—	—	—	
Intangible assets	—	—	—	—	—	—	—	—	—	

Property, plant and equipment	—	—	—	—	0.4	0.4	5	—	—	7.
Deferred tax	—	—	—	—	—	—	—	—	—	
Prepayments, accrued income and other assets	—	—	—	—	—	—	—	—	—	
Assets of disposal groups	—	—	—	—	—	—	—	—	—	
	50.9	16.7	34.4	60.9	8.6	171.5		166.8	101.5	183.
Own asset securitisations								17.4		
Total liquidity portfolio								184.2		
Liabilities secured										
Intra-Group - used for secondary liquidity	(19.1)	—	—	—	—	(19.1)				
Intra-Group - other	(18.4)	—	—	—	—	(18.4)				
Third-party (5)	(7.8)	(9.0)	(42.7)	(85.1)	(6.0)	(150.6)				
	(45.3)	(9.0)	(42.7)	(85.1)	(6.0)	(188.1)				

Notes:

(1) Encumbered assets are those on the balance sheet that have been pledged to provide security for the liability shown above and are therefore not available to secure funding or to meet other collateral needs.

(2) Unencumbered readily realisable assets are those assets on the balance sheet that can be readily used to meet funding or collateral requirements and comprise:

(a) Liquidity portfolio: cash balances at central banks, high quality debt securities and loans that have been pre-positioned with central banks. In addition, the liquidity portfolio includes securitisations of own assets which has reduced over the years and has been replaced by loans.

(b) Other readily realisable assets: other liquidity reserves, including assets that have been enabled for use with central banks; and unencumbered debt securities.

(3) Unencumbered other realisable assets are those assets on the balance sheet that have no restrictions for funding and collateral purposes but are not readily realisable in their current form. These assets include loans that could be prepositioned with central banks but have not been subject to internal and external documentation review and diligence work.

(4) Assets that cannot be encumbered comprise:

(a) derivatives, reverse repurchase agreements and trading related settlement balances.

(b) non-financial assets such as intangibles, prepayments and deferred tax.

(c) assets in disposal groups.

(d) loans that cannot be pre-positioned with central banks based on criteria set by the central banks, primarily US, including date of origination and level of documentation.

(e) non-recourse invoice financing balances and certain shipping loans whose terms and structure prohibit their use as collateral.

(5)

In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

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Business review Risk and balance sheet management

Funding risk continued

Encumbrance continued

	Encumbered assets relating to:									
	Debt securities in issue		Other secured liabilities			Total	Encumbered	Unencumbered		
	Securitisations and conduits	Covered bonds	Derivatives	Repos	Secured deposits	encumbered assets	assets as a % of related assets	Liquidity portfolio	Other	Total
2012	£bn	£bn	£bn	£bn	£bn	£bn		£bn	£bn	£bn
Cash and balances at central banks	—	—	—	—	—	—	—	70.2	9.1	79.3
Loans and advances to banks	5.3	0.5	12.8	—	—	18.6	59	—	12.7	31.3
Loans and advances to customers										
- UK residential mortgages	16.4	16.0	—	—	—	32.4	30	58.7	18.0	109.1
- Irish residential mortgages	10.6	—	—	—	1.8	12.4	81	—	2.9	15.3
- US residential mortgages	—	—	—	—	—	—	—	7.6	14.1	21.7
- UK credit cards	3.0	—	—	—	—	3.0	44	—	3.8	6.8
- UK personal loans	4.7	—	—	—	—	4.7	41	—	6.8	11.5
- other	20.7	—	22.5	—	0.8	44.0	16	6.5	217.1	267.6
Reverse repurchase agreements and stock borrowing	—	—	—	—	—	—	—	—	104.8	104.8
Debt securities	1.0	—	8.3	91.2	15.2	115.7	70	22.3	26.6	164.6
Equity shares	—	—	0.7	6.8	—	7.5	49	—	7.7	15.2
Settlement balances	—	—	—	—	—	—	—	—	6.7	6.7
Derivatives	—	—	—	—	—	—	—	—	441.9	441.9
Intangible assets	—	—	—	—	—	—	—	—	14.3	14.3
Property, plant and equipment	—	—	—	—	—	—	—	—	10.0	10.0
Deferred tax	—	—	—	—	—	—	—	—	3.5	3.5

Prepayments, accrued income and other assets	—	—	—	—	—	—	—	—	8.7	8.7
	61.7	16.5	44.3	98.0	17.8	238.3		165.3	908.7	1,312.3
Own asset securitisations								22.6		
Total liquidity portfolio								187.9		
Liabilities secured										
Intra-Group - used for secondary liquidity	(22.6)	—	—	—	—	(22.6)				
Intra-Group - other	(23.9)	—	—	—	—	(23.9)				
Third-party (1)	(12.0)	(10.1)	(60.4)	(132.4)	(15.3)	(230.2)				
	(58.5)	(10.1)	(60.4)	(132.4)	(15.3)	(276.7)				

Note:

(1) In accordance with market practice the Group employs its own assets and securities received under reverse repo transactions as collateral for repos.

For information on collateral received and used relating to securities financing transactions (SFT) and derivatives refer to the following page.

Funding risk continued

Summary of assets available as collateral (on and off-balance sheet)*

The table below summarises total on and off-balance sheet assets that are available to support funding and collateral requirements.

	2013 £bn
Total on-balance sheet assets	1,027.9
Less:	
- Reverse repos and derivatives	(364.5)
- Other assets not available to be pledged	(40.5)
Total on-balance sheet assets available	622.9
Add:	
- Fair value of securities received as collateral from reverse repo and derivative transactions	124.2
Total assets available	747.1
Less:	
- On-balance sheet assets pledged	(171.5)
- Reverse repo and derivative securities collateral that have been rehypothicated	(111.5)
Assets available to be pledged	464.1

Key point

- Of the £464.1 billion collateral available, £166.8 billion is in the Group's liquidity portfolio. The remainder is available to support for general funding and collateral needs.

*unaudited

Credit risk

Credit risk
Definition
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.

Sources of credit risk
The Group is exposed to credit risk as a result of a wide range of business activities. The most significant source of credit risk is lending. The second most significant source is counterparty credit risk, which results from the Group's activities in the derivatives and securities financing transaction markets.

The Group offers a number of lending products where it has an irrevocable obligation to provide credit facilities to a customer. Security may be obtained to mitigate the risk of loss in the form of physical collateral, such as commercial real estate assets and residential property, or financial collateral such as cash or bonds. Also included in the Group's lending are exposures arising from leasing activities.

Derivatives and securities financing transactions expose the Group to counterparty credit risk, which is the risk of loss arising from a failure of a customer to meet obligations which vary in value by reference to a market factor.

The Group holds debt securities with the intention of selling them and so is exposed to market risk. However, it also holds some debt securities generally for liquidity management purposes, and is exposed to credit risk as a result.

The Group is exposed to credit risk from off-balance sheet products such as trade finance activities and guarantees.

Credit risk governance
A strong credit risk management function is vital to support the ongoing profitability of the Group. The potential for loss is mitigated through a robust credit risk culture in the business units and through a focus on sustainable lending practices. The Group's credit risk management function is responsible for credit approval and managing concentration risk, as well as credit risk control frameworks and acts as the ultimate authority for the approval of credit. This, together with strong independent oversight and challenge, enables the business to maintain a sound credit environment.

The Group Chief Credit Officer (GCCO), through the Group Credit Risk (GCR) function, is responsible for the development of, and ensuring compliance with, Group-wide policies and credit risk frameworks as well as Group-wide assessment of provision adequacy. The risk management functions, located in the Group's business divisions, are responsible for the execution of these policies.

The divisional credit risk management functions work together with GCR to ensure that the risk appetite set by the Group Board is met. The credit risk function in each division is managed by a Chief Credit Officer, who reports jointly to a divisional Chief Risk Officer and to the GCCO. Divisional credit risk management activities include transaction analysis, credit approval, ongoing credit risk stewardship, and early problem identification and management.

The Executive Risk Forum (ERF) considers and approves material aspects of the Group's credit risk management framework, such as credit risk appetite and limits for portfolios of strategic significance. The ERF has delegated approval authority to the Group Credit Risk Committee, a functional sub-committee of the Group Risk Committee, to act on credit risk matters. These include, but are not limited to, credit risk appetite and limits (within the overall risk appetite set by the Board and the ERF), credit risk strategy and frameworks, credit risk policy and the oversight of the credit profile across the Group. There are separate Group Credit Risk Committees for the retail and wholesale portfolios and these are chaired by the GCCO.

The Group Audit Committee (GAC) provides oversight of the Group's provision adequacy. The GCCO is accountable to the GAC for the adequacy of the Group's provisions, both individual and collective. The Group Provisions Committee, which is chaired by either the Group Chief Risk Officer or the GCCO, approves recommendations from the divisional provisions committees.

Key trends in the credit risk profile of the Group, performance against limits and emerging risks are set out in the RBS Risk Management Monthly Report provided to the Executive Committee, the Board Risk Committee and the Group Board.

Risk appetite and concentration framework

Risk appetite is set using specific quantitative targets under stress, including earnings volatility and capital adequacy. The Group's credit risk framework has therefore been designed around the factors that influence the Group's ability to meet those targets. These include product and asset class, industry sector, single name and country concentrations. Any of these factors could generate higher earnings volatility under stress and, if not adequately controlled, could undermine capital adequacy. Tools such as stress testing and economic capital are used to measure credit risk volatility and develop links between Group risk appetite targets and the credit risk control framework. The frameworks are supported by a suite of Group-wide and divisional policies that set out the risk parameters within which divisions must operate. The Group also manages its exposures to counterparty credit risk closely, using portfolio limits and specific tools to control more volatile or capital intensive business areas.

Wholesale

Four formal frameworks are used to manage wholesale credit concentration risk. The Group continually reassesses its frameworks to ensure that they remain appropriate for its varied business franchises and current economic conditions, as well as to reflect further refinements in the Group's risk measurement models.

Credit risk continued
Risk management*
Product/asset class concentration framework
The Group manages certain lines of business where the nature of credit risk assumed could result in a concentration or a heightened risk in some other form. This includes specific credit risk types such as settlement or wrong-way risk and products such as long-dated derivatives or securitisations. These product and asset classes may require formal policies and expertise as well as tailored monitoring and reporting measures. In some cases specific limits and thresholds are deployed to ensure that the credit risk inherent in these lines of business and products is adequately controlled. Product and asset classes are reviewed regularly. The reviews consider the risks inherent in each product or asset class, the risk controls applied, monitoring and reporting of the risk, the client base, and any emerging risks to ensure risk appetite remains appropriate.

Sector concentration
Exposures are assigned to, and reviewed in the context of, a defined set of industry sectors. Risk appetite and portfolio strategies are set at either the sector or sub-sector level, depending on where exposures may result in excessive concentration, or where trends in both external factors and internal portfolio performance give cause for concern. Regular formal reviews are undertaken at Group or divisional level depending on materiality. Reviews may include an assessment of the Group's franchise in a particular sector, an analysis of the outlook, identification of key vulnerabilities or stress testing.

As a result of the reviews carried out in 2013, the Group further reduced its risk appetite in the corporate sectors of commercial real estate and retail. For further details on sector-specific strategies, exposure reduction and key credit risks, refer to pages 247 to 262.

Single name concentration
A single name concentration (SNC) framework addresses the risk of outsized exposure to a borrower or borrower group. The framework includes elevated approval authority, additional reporting and monitoring, and the requirement for plans to address exposures in excess of appetite.

Several credit risk mitigation techniques are available to reduce single name concentrations. If the Group decides that its exposure is too high, it may decide to sell excess exposures. Alternatively, it may decide to take additional security or guarantees such as cash, bank or government guarantees or enter into credit default swaps. Credit risk mitigants must be effective in terms of legal certainty and enforceability. In addition, maturity or expiry dates must be the same, or later, than the underlying obligations.

Aggregate SNC exposures remain outside of the Group's longer-term appetite. However, material reductions have been achieved since the framework was introduced. This trend continued during the year, with a 21% decrease in the number of excesses since December 2012.

Country concentration
The country concentration framework is described in the Country risk section on pages 336 to 348.

Retail
A product and asset class framework exists to control credit risk for retail businesses. It sets limits that measure and control the asset quality of each key business area, the portfolios in that business and the new business being originated. The actual performance of each portfolio is tracked relative to these limits and action taken where necessary.

Credit risk assessment
Wholesale
The credit risk function assesses, approves and manages the credit risk associated with a borrower or group of related borrowers.

The GCCO has established a framework of individual delegated authorities, which are set out in the Group Credit Risk Policy. The framework requires at least two individuals to approve each credit decision, one from the business and one from the credit risk function. Both must hold appropriate delegated authority, which is dependent on their experience and expertise. Only a small number of senior executives hold the highest authority provided under the framework. While both parties are accountable for the quality of each decision taken, the credit risk approver holds ultimate sanctioning authority.

In all circumstances the risks associated with any proposal to provide, increase, review or change the terms or conditions of credit facilities must be assessed prior to a credit decision being made. Assessments of credit risk must, at a minimum, specifically address the following elements:

- The amount, terms, tenor, structure, conditions, purpose and appropriateness of all credit facilities;
- Compliance with applicable Group and/or divisional credit policies;
- The customer's ability to meet obligations, based on an analysis of financial information and a review of payment and covenant compliance history;
- The source of repayment and the customer's risk profile, including sector analysis and sensitivity to economic and market developments, and credit risk mitigation;
- Refinancing risk - that is the risk of loss arising from the failure of a customer to settle an obligation on expiry of a facility through the drawdown of another credit facility provided by the Group or by another lender;
- Consideration of all other risks such as environmental, social and ethical, regulatory and reputational risks; and
- The portfolio impact of the transaction, including the impact on any credit risk concentration limits or agreed divisional risk appetite.

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; compliance with terms and conditions; and refinancing risk.

*unaudited

Credit risk continued

Risk management* continued

Retail

Retail lending entails making a large number of small value loans. To ensure that it makes these lending decisions consistently, the Group analyses the historical debt servicing behaviour of customers, including their behaviour with respect to their other lenders. The Group then uses the results of these analyses to set its lending rules, developing different rules for different products. The resulting credit decision making process is then largely automated, with customers receiving a credit score that reflects the outcome of a comparison of their credit profile with the rule set. However, in the case of relatively high value, complex personal or small business loans, including some residential mortgage lending, specialist credit managers make the final lending decisions.

Controls and assurance

The Group's credit control and assurance framework has three key components: credit policy; policy compliance assurance; and independent assurance. These apply to both wholesale and retail credit risk at both portfolio and individual customer level.

The first component is the Group Credit Policy Standard, which is part of the Group Policy Framework. It sets out the rules the Group's businesses must follow to ensure that credit risks are identified and effectively managed through the credit lifecycle.

The second component is a policy assurance activity that GCR undertakes to provide the GCCO with evidence of the effectiveness of credit risk management controls in place across the Group. The results of these reviews are presented to the Group Credit Risk Committee on a regular basis in support of the self-certification that GCR must complete from time to time.

The third component of the Group's credit assurance framework is the Credit Quality Assurance (CQA) function. CQA independently reviews the Group's lending activities to identify control breaches, assess portfolio quality and recommend process improvements. These findings are escalated to senior management and plans to address shortcomings are recorded and tracked in the Group's operational risk system. CQA's activities are overseen by GAC and the results of its reviews are regularly shared with the Group's main regulators.

Risk measurement*

The Group uses a range of measures for credit risk exposures. The internal measure used, unless otherwise stated, is credit risk assets (CRA) consisting of:

- Lending exposure - measured using drawn balances and includes cash balances at central banks and loans and advances to banks and customers (including overdraft facilities, instalment credit and finance leases).

- Counterparty exposures - measured using marked-to-market value of derivatives after the effect of enforceable netting agreements and regulatory approved models but before the effect of collateral. Counterparty exposures include rate risk management, which includes exposures arising from foreign exchange transactions, interest rate swaps, credit default swaps and options. Exposures are mitigated by off-setting in-the-money and out-of-the-money transactions where such transactions are governed by legally enforceable netting agreements and exposures are calculated by regulatory approved models. Exposures are shown before deducting collateral.

- Contingent obligations - measured using the value of the committed amount and including primarily letters of credit and guarantees.

CRA exclude issuer risk (primarily debt securities) and securities financing, repurchase and reverse repurchase arrangements. CRAs take account of regulatory netting although, in practice, obligations are settled under legal netting arrangements that provide a right of legal set-off but do not meet the offset criteria under IFRS.

Credit risk models
The Group uses credit risk models in the credit approval process, ongoing credit risk management, monitoring and reporting and portfolio analytics. These may be divided into three categories:

Probability of default (PD)
PD models assess the probability of a customer failing its credit obligations over a one year period.

- Wholesale models - A number of credit grading models are in place that consider risk characteristics relevant to different customer types. These models use a combination of quantitative inputs, such as recent financial performance, and qualitative inputs such as management performance or sector outlook. As part of the credit assessment process, the Group assigns each customer an internal credit grade based on its PD.

- Retail models - Each customer account is scored and models are used to assign a PD. Inputs vary across portfolios and include both internal account and customer level data, as well as data from credit bureaus. This score is used to support automated credit decision making through the use of a statistically derived scorecard.

Exposure at default (EAD)
EAD models provide estimates of the level of use of a credit facility at the time of a customer's default, recognising that customers may make further drawings on unused credit facilities prior to default. Regulatory requirements determine that EAD is always equal to or higher than current utilisation. Exposure can be reduced by a netting agreement, subject to meeting standards of legal enforceability.

*unaudited

Credit risk continued
Risk measurement* continued
Loss given default (LGD)
LGD models estimate the amount that cannot be recovered in the event of customer default. When estimating LGD, the Group's models assess both borrower and facility characteristics, as well as various credit risk mitigants. The cost of collections and a time discount factor for the delay in cash recovery are also incorporated.

Changes to credit models
The Group reviews and updates models on an ongoing basis, reflecting more recent data, changes to products and portfolios, and updated regulatory requirements. Extensive changes were made to wholesale models in 2012 and 2013. This process continues with further changes, notably in banks and corporate exposure classes, planned for 2014.

As in 2012, the impact of the model changes implemented in 2013 largely affected the lower risk segments of the Group's portfolios, mostly to customers bearing the equivalent of investment-grade ratings.

Model changes affect year-on-year comparisons of risk measures in certain disclosures. Where meaningful, the Group in its commentary has differentiated between instances where movements in risk measures reflect the impact of model changes, and those that reflect movements in the size of underlying credit portfolios or their credit quality.

Economic capital
The credit economic capital model is an extensive framework that allows for the calculation of portfolio credit loss distributions and associated metrics over a given risk horizon for a variety of business purposes.

The model takes into account migration risk (risk that credit assets will deteriorate in credit quality across multiple years), factor correlation (the assumption that groups of obligors share a common factor) and contagion risk (for example, the risk that the weakening of the sovereign's creditworthiness has a significant impact on the creditworthiness of a business operating in that country).

Credit risk assets*
The table below provides a bridge between balance sheet captions and the related components of credit risk assets (CRA).

2013	Balance sheet £bn	Within the scope of market risk (1) £bn	Not within the scope of CRA (2) £bn	Credit adjustments (3) £bn	Netting and collateral (4) £bn	Methodology differences and reclassifications (5) £bn	CRA £bn
Cash and balances at central banks	82.7	—	(3.9)	—	—	1.7	80.5
Reverse repurchase agreements and stock borrowing	76.4	—	(76.4)	—	—	—	—
Loans and advances	418.4	—	(3.0)	25.2	(28.4)	(7.5)	404.7
Debt securities	113.6	(56.7)	(56.9)	—	—	—	—
Equity shares	8.8	(7.2)	(1.6)	—	—	—	—
Settlement balances	5.6	(5.6)	—	—	—	—	—

Derivatives	288.0	—	—	1.8	(242.8)	9.9	56.9
Other assets (6)	34.4	—	(25.6)	—	—	(7.8)	1.0
Total assets	1,027.9	(69.5)	(167.4)	27.0	(271.2)	(3.7)	543.1
Contingent obligations (7)							29.9
							573.0

Notes:
(1) The exposures in regulatory trading book businesses are subject to market risk and are hence excluded from CRA. Refer to the market risk section on page 313.
(2) Includes cash in ATMs and branches, items in the course of collection, reverse repurchase agreements, securities and other assets (refer to note below).
(3) Includes impairment loss provisions related to loans and advances and credit valuation adjustment on derivatives.
(4) Comprises:
- Loans and advances: cash collateral pledged with counterparties in relation to net derivative liability positions.
- Derivatives: impact of master netting arrangements.
(5) Comprises:
-Cash and balances at central banks: notice balances with central banks included in loans and advances, reclassified as central bank exposure in CRA.
-Loans and advances: includes offset related to cash management pooling arrangements not allowed under IFRS and reclassification of central bank balances. This is partially offset byreclassification of disposal groups and prepayments, accrued income and other assets as customer balances.
- Derivatives: reflects difference between netting arrangements and netting within regulatory model sets, and balances with central counterparties after netting but before variation margin presentednet on the balance sheet.
-Other assets: includes amounts reclassified to loans and advances from disposal groups and prepayments, accrued income and other assets and residual value of operating leases.
(6) Other assets: includes intangible assets, property, plant and equipment, deferred tax, prepayments and accrued income and assets of disposal groups.
(7) Includes documentary credits (commercial letters of credit providing for payment by the Group to a named beneficiary against presentation of specified documents), classified as commitments for financial reporting.

*unaudited

Credit risk continued
Credit risk assets* continued
Divisional analysis

	2013	2012	2011
	£m	£m	£m
UK Retail	113,223	114,120	111,070
UK Corporate	97,166	101,148	105,078
Wealth	19,819	19,913	20,079
International Banking	60,438	64,518	72,737
Ulster Bank	33,129	34,232	37,781
US Retail & Commercial	53,411	55,036	56,546
Retail & Commercial	377,186	388,967	403,291
Markets	81,021	106,336	114,327
Other	71,409	65,186	64,517
Core	529,616	560,489	582,135
Non-Core	43,340	65,220	92,709
	572,956	625,709	674,844

Key points

- Overall, CRA fell by 8% during the year. 59% of the £52.8 billion reduction was in the Core divisions.

- CRA in the Retail & Commercial divisions continued to increase as a proportion of the Core portfolio, accounting for 71% of the Core CRA (2012 - 69%).

- The reduction in the Core portfolio was mostly driven by the implementation of a risk reduction strategy in Markets. CRA in Markets fell by 24% during the year, affected by a contraction in lending and rate risk management activities. Markets represented 15% of Core CRA (2012 - 19%). CRA decreased in all Core divisions with the exception of 'other'.

- The increase in CRA in 'other' predominantly related to Group Treasury's exposure to central banks in the UK and US and was a function of the Group's liquidity requirements and cash positions. Exposures to central banks in Western Europe decreased by 76% year-on-year and at the year end represented 7% of 'other' exposure (2012 - 32%).

- At the year end, Non-Core accounted for 8% of total CRA (2012 - 10%) as asset disposals and run-offs continued. Some 50% of the reduction in Non-Core was in the property sector as the Group continued to reduce its concentration in this sector, in particular commercial real estate.

*unaudited

Credit risk continued

Credit risk assets* continued

Sector and geographical regional analyses

The table below details CRA by sector and geographical region. Sectors are based on the Group's sector concentration framework. Geographical region is based on the location of the customer's operations (or, in the case of individuals, location of residence).

	UK	Western Europe (excl. UK)	North America	Asia Pacific	Latin America	Other (1)	Total	Core	Non-Core
2013	£m	£m	£m	£m	£m	£m	£m	£m	£m
Personal	127,620	18,751	28,616	1,418	61	656	177,122	174,798	2,324
Banks	2,506	25,085	3,133	9,670	1,192	1,771	43,357	43,010	347
Other financial institutions	23,080	10,363	9,164	2,633	1,320	1,100	47,660	43,849	3,811
Sovereign (2)	55,041	8,685	18,203	3,394	37	687	86,047	84,726	1,321
Property	49,639	18,673	6,206	929	286	795	76,528	53,569	22,959
Natural resources	6,698	4,587	6,189	3,669	214	2,087	23,444	21,412	2,032
Manufacturing	8,843	4,962	6,208	2,278	120	1,397	23,808	23,276	532
Transport (3)	10,332	3,936	3,959	1,800	163	9,435	29,625	24,086	5,539
Retail and leisure	16,338	3,924	4,977	738	91	517	26,585	24,562	2,023
Telecoms, media and technology	3,356	2,591	3,401	1,403	29	491	11,271	9,810	1,461
Business services	16,527	2,733	6,053	757	1,233	206	27,509	26,518	991
	319,980	104,290	96,109	28,689	4,746	19,142	572,956	529,616	43,340
2012									
Personal	129,431	19,256	30,664	1,351	39	926	181,667	177,880	3,787
Banks	5,023	36,573	6,421	8,837	1,435	2,711	61,000	60,609	391
Other financial institutions	20,997	13,398	10,189	2,924	4,660	789	52,957	47,425	5,532
Sovereign (2)	38,870	26,002	14,265	2,887	64	1,195	83,283	81,636	1,647
Property	54,831	23,220	7,051	1,149	2,979	1,280	90,510	56,566	33,944
Natural resources	6,103	5,911	6,758	4,129	690	1,500	25,091	21,877	3,214
Manufacturing	9,656	5,587	6,246	2,369	572	1,213	25,643	24,315	1,328
Transport (3)	12,298	5,394	4,722	5,065	2,278	4,798	34,555	26,973	7,582
Retail and leisure	17,229	5,200	4,998	1,103	270	658	29,458	26,203	3,255
Telecoms, media and technology	4,787	3,572	3,188	1,739	127	346	13,759	10,815	2,944
Business services	17,089	3,183	5,999	581	780	154	27,786	26,190	1,596
	316,314	147,296	100,501	32,134	13,894	15,570	625,709	560,489	65,220
2011									
Personal	126,945	20,254	33,087	1,604	158	1,114	183,162	176,201	6,961
Banks	4,720	39,213	3,952	11,132	1,738	3,276	64,031	63,470	561
	16,549	15,960	13,319	3,103	5,837	1,159	55,927	45,548	10,379

Other financial institutions									
Sovereign (2)	21,053	31,374	31,391	3,399	78	1,581	88,876	87,617	1,259
Property	60,099	27,281	8,052	1,370	3,471	1,480	101,753	58,323	43,430
Natural resources	6,552	7,215	8,116	3,805	1,078	2,508	29,274	25,146	4,128
Manufacturing	9,583	7,391	7,098	2,126	1,011	1,381	28,590	26,525	2,065
Transport (3)	13,789	7,703	4,951	5,433	2,500	5,363	39,739	27,529	12,210
Retail and leisure	22,775	6,101	5,762	1,488	1,041	675	37,842	32,766	5,076
Telecoms, media and technology	5,295	4,941	3,202	1,944	139	609	16,130	12,180	3,950
Business services	17,851	3,719	6,205	910	629	206	29,520	26,830	2,690
	305,211	171,152	125,135	36,314	17,680	19,352	674,844	582,135	92,709

Notes:

(1) Comprises Central and Eastern Europe, the Middle East, Central Asia and Africa, and supranationals such as the World Bank.

(2) Includes cash held at central banks.

(3) Excludes net investment in operating leases in shipping and aviation portfolios as they are accounted for as property, plant and equipment. However, operating leases are included in the monitoring and management of these portfolios.

*unaudited

Credit risk continued
Credit risk assets* continued
Key points
Financial markets and the Group's focus on risk appetite and sector concentration had a direct impact on the portfolio during the year with the following key trends observed:

- Total CRA fell 8%, with the only notable increase being in the sovereign sector, including exposures to central banks (increased 3%). Excluding sovereign exposures, CRA decreased by 10%.

- At the year end, the portfolio comprised 31% personal exposure (2012 - 29%), sovereign 15% (2012 - 13%) exposure to banks and other financial institutions 16% (2012 - 18%), property 13% (2012 - 14%), and other corporate sectors 25% (2012 - 26%).

- CRA fell in all geographic regions. The largest decrease, in Western Europe, was primarily a result of reduced exposures to European central banks.

- UK exposure increased to 56% of CRA (2012 - 51%) because of a £16.2 billion rise in exposure to the Bank of England. This was offset predominantly by falls in Non-Core property (£7.5 billion) and Core personal and banking sectors, which fell £4.3 billion in total. Excluding sovereigns, UK Core exposure fell by 3%).

- The personal sector, excluding exposures in North America, fell by 2% due to reduced overdraft and lending exposure in the UK. This was offset by slightly increased UK mortgage exposure. Personal exposure in North America decreased disproportionately due to Non-Core exposures.

- Exposure to sovereigns fluctuates according to Group liquidity requirements and cash positions. These are driven by inflows and outflows of deposits which determine the level of cash placed with central banks and have contributed to higher exposures at the Bank of England and lower exposures at European central banks. The Group's sovereign portfolio comprises exposures to central governments, central banks and sub-sovereigns such as local authorities, primarily in the Group's key markets of the UK, Western Europe and the US. The asset quality is high because exposures are largely short-term cash balances placed with central banks such as the Bank of England, the Federal Reserve and the Eurosystem (including the European Central Bank and central banks in the eurozone). Information on the Group's exposure to governments, including peripheral eurozone sovereigns, can be found in the Country risk section.

- Exposure to the banking sector is well diversified geographically. Limits and exposures are tightly controlled through the combination of the SNC framework, bespoke credit policies and country limits. Derivatives generated the largest exposure for banks (58% of credit risk assets in the banks sector), but a large portion of the exposures was collateralised. The increase in bank exposure in the Asia Pacific region was largely driven by short-term, trade finance related activities.

- Exposure to banks and financial institutions declined by 20%. This was primarily as a result of limited lending and interbank money market activity which fell by 8% and a reduction in derivative exposures which fell by 27%. The declining trend in interbank activity was largely attributable to increased bank liquidity including access to liquidity via schemes put in place via central banks and governments. The reduction in derivative exposure was due to the Group exiting certain products and the benefits of regulatory netting derived from the implementation of new modelling methodology. The Group has a suite of control frameworks and policies for managing the derivatives portfolio, particularly uncollateralised derivatives with long tenors. During the year the control framework for this segment of the portfolio was further tightened.

- Exposure to other financial institutions comprises a range of financial companies, the largest of which were funds (25%) securitisation vehicles (22%) and financial intermediaries (16%) including broker dealers and central counterparties (CCPs). The Core other financial institutions portfolio decreased by 8% in 2013. The Non-Core portfolio decreased by 31%.

- At the year end, the total exposure to CCPs was £4.1 billion (2012 - £3.2 billion). Regulatory initiatives to encourage the wider use of CCPs for clearing over-the-counter derivatives across the industry continue. The Group supports this move but recognises that its concentration risk to CCPs will continue to rise when it clears its own trades, as well as when it acts as a clearing broker for third parties. This increased concentration risk is being managed under a specific risk appetite and control framework. The Group's CCP exposure remains dominated by a small number of well-established, high quality and reputable clearing houses.

- The Group continued to manage down its exposures to financial guarantors - credit derivative products companies (CDPCs) and monolines with a view to exiting these portfolios. Exposure to financial guarantors declined by 69% and represented less than 1% of the other financial institutions portfolio (2012 - 2%). Exposures have decreased materially over time as trades are commuted and exposures reduced due to the tightening credit spread of the assets protected by CDPCs and monolines. At the year end, exposures to CDPCs and monolines totalled £274 million (2012 - £874 million).

- The majority of the Group's property exposure was commercial real estate in Ireland and the UK (refer to Commercial real estate on pages 247 to 252 for further details). The remainder comprised lending to construction companies and building materials groups, which fell by £1.7 billion (15%), and housing associations, which increased by £0.9 billion (12%). A total of 59% of the Group's Core property exposure was in UK Corporate (2012 - 60%) with Ulster Bank and US Retail & Commercial representing 10% and 9% respectively, unchanged from 2012.

*unaudited

Credit risk continued
Credit risk assets*continued

- The Group's exposure to the shipping sector (including shipping related infrastructure) declined by 18% in 2013 as a result of scheduled loan amortisation, secondary sales and prepayments. Out of the total exposure of £11.4 billion, £8.6 billion related to asset-backed exposure to ocean-going vessels of which dry bulk accounted for 35% of the exposure, tankers 34%, container ships 15%, gas 10% and other vessels 6%. Conditions remained poor across the major shipping market segments in 2013, as charter rates and vessel values remained depressed. The majority of the Group's exposure is extended against security in vessels of recent construction, with less than 4% of the lending secured on vessels aged over 15 years. A key protection for the Group is the minimum security covenant. The overall loan-to-value (LTV) on the portfolio at 31 December 2013 was 76%, split 70% for Core and 97% for Non-Core portfolio respectively. Within the Core portfolio, 13% of exposure had LTVs greater than 100%.

- An increased number of clients suffered liquidity challenges during the year or failed to meet their minimum security covenant. This led to a commensurate rise in referrals to the Watchlist and transfers to the Global Restructuring Group. At 31 December 2013, 12% of the Group's exposure to this sector was in the Watch Red category and loans in default amounted to £0.9 billion.

- The reduction in exposure in the retail and leisure sector was consistent with the Group's strategies to re-balance the Core portfolios towards stronger customers in the sector while continuing to reduce the Non-Core book. The modest growth in North America was in line with agreed sector and region risk appetite.

- Exposure in the telecoms, media and technology sector fell by 18% during the year, driven by divisional strategies to exit underperforming sub-sectors in the portfolio. Notably, media exposure fell 31% during the year.

- Exposure to healthcare of £9.5 billion at the year end (2012 - £9.9 billion) was included in the business services sector. The Group's healthcare exposure was heavily biased towards the UK, which represented 68% of the exposure, unchanged from 2012.

*unaudited

Credit risk continued
Credit risk assets* continued
Asset quality (AQ)
Internal reporting and oversight of CRA is principally differentiated by credit grades. Customers are assigned credit grades based on various credit grading models that reflect the key drivers of default for each customer type. All credit grades across the Group map to both a 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. Accordingly, measures of risk exposure may be readily aggregated and reported at increasing levels of granularity depending on stakeholder or business need. Performing loans are defined as AQ1-AQ9 (where the PD is less than 100%) and non-performing loans as AQ10 (where the PD is 100%).

Exposures are allocated to asset quality bands on the basis of statistically driven models, which produce an estimate of default rate. The variables included in the models vary by product and geography. For portfolios secured on residential property these models typically include measures of delinquency and loan to value as well as other differentiating characteristics such as bureau score, product features or associated account performance information.

The table below shows CRA by asset quality band.

AQ band	Probability of default range	2013 Core £m	2013 Non-Core £m	2013 Total £m	2013 Total %	2012 Core £m	2012 Non-Core £m	2012 Total £m	2012 Total %	2011 Core £m	2011 Non-Core £m	2011 Total £m	2011 Total %
AQ1	0% - 0.034%	129,197	3,319	132,516	23.1	131,772	7,428	139,200	22.2	195,826	13,732	209,558	31.1
AQ2	0.034% - 0.048%	22,942	1,485	24,427	4.3	25,334	2,241	27,575	4.4	18,366	2,915	21,281	3.2
AQ3	0.048% - 0.095%	41,325	700	42,025	7.3	43,925	2,039	45,964	7.3	27,082	2,883	29,965	4.4
AQ4	0.095% - 0.381%	114,258	5,737	119,995	20.9	112,589	6,438	119,027	19.0	65,491	9,636	75,127	11.1
AQ5	0.381% - 1.076%	77,676	2,585	80,261	14.0	92,130	7,588	99,718	15.9	92,503	10,873	103,376	15.3
AQ6	1.076% - 2.153%	44,476	3,138	47,614	8.3	45,808	5,525	51,333	8.2	67,260	6,636	73,896	11.0
AQ7	2.153% - 6.089%	31,504	2,060	33,564	5.9	32,720	5,544	38,264	6.1	36,567	8,133	44,700	6.6
AQ8	6.089% - 17.222%	9,492	899	10,391	1.8	13,091	1,156	14,247	2.4	11,921	3,320	15,241	2.3
AQ9	17.222% - 100%	6,741	771	7,512	1.3	8,849	2,073	10,922	1.8	12,710	5,024	17,734	2.6
AQ10	100%	21,814	20,743	42,557	7.4	21,562	22,845	44,407	7.1	20,017	25,020	45,037	6.7
Other (1)		30,191	1,903	32,094	5.7	32,709	2,343	35,052	5.6	34,392	4,537	38,929	5.7
		529,616	43,340	572,956	100	560,489	65,220	625,709	100	582,135	92,709	674,844	100

Note:
(1) Largely comprises assets covered by the standardised approach, for which a probability of default equivalent to those assigned to assets covered by the internal ratings based approach is not available.

	2013		2012		2011	
	AQ10	Divisional credit risk assets	AQ10	Divisional credit risk assets	AQ10	Divisional credit risk assets
AQ10 CRA by division	£m	%	£m	%	£m	%
UK Retail	4,462	3.9	4,998	4.4	5,097	4.6
UK Corporate	6,279	6.5	6,310	6.2	5,484	5.2
International Banking	572	0.9	612	0.9	1,736	2.4
Ulster Bank	9,198	27.8	8,236	24.1	6,305	16.7
US Retail & Commercial	536	1.0	633	1.2	646	1.1
Retail & Commercial	21,047	5.6	20,789	5.3	19,268	4.8
Markets	767	0.9	773	0.7	749	0.7
Core	21,814	4.1	21,562	3.8	20,017	3.4
Non-Core	20,743	47.9	22,845	35.0	25,020	27.0
	42,557	7.4	44,407	7.1	45,037	6.7

*unaudited

Credit risk continued
Credit risk assets* continued
Key points

- Trends in the asset quality of the Group's credit risk exposures during 2013 reflected the change in the proportion of assets in the sovereign sector and movements in the underlying asset quality of the portfolio. The Group's overall asset quality for performing assets improved slightly year-on-year.

- The increase in the proportion of the Group's Core exposures in the AQ1 band reflected the increase in the Group's exposure to sovereigns, in line with the Group's liquidity and capital management practices.

- The increase in AQ4 was due to a positive shift in the asset quality band distribution of UK Retail and reflected improvements in the underlying credit quality of the UK Retail mortgage portfolio over the last three years.

- Trends in the Group's non-performing credit risk exposures in 2013 were predominantly driven by the Non-Core and Ulster Bank portfolios, with these two divisions accounting for 70% of the Group's AQ10 CRA.

- Property continued to be the largest sector in non-performing assets - 57% of total AQ10 exposure (2012 - 58%).

- Non-performing assets in the Ulster Bank portfolio continued to grow, driven by exposures in the wholesale property sector. Refer to Key loan portfolios: Ulster Bank Group (Core and Non-Core) on pages 260 to 262 for more details.

- The personal sector accounted for 21% (2012 - 21%) of the Group's AQ10 exposure. AQ10 exposure in this sector decreased during the year for all divisions except Ulster Bank.

- In UK Retail non-performing assets continued to fall, principally as a result of lower flows of assets into non-performing across all portfolios, as well as write-downs of aged debt.

- The slight decrease in the level of AQ10 exposure in UK Corporate was driven primarily by reductions in the property sector, offset by increases in shipping. At the year end, shipping represented 12% of the AQ10 assets in UK Corporate (2012 - 8%).

- Non-Core exposure fell in all AQ bands.

Risk mitigation
Risk mitigation techniques are used in the management of credit portfolios across the Group, typically to mitigate credit concentrations in relation to an individual customer, a borrower group or a collection of related borrowers. Where possible, the Group nets customer credit balances against obligations.

Mitigation tools applied 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.

When seeking to mitigate risk, at a minimum the Group considers the following:

- The suitability of the proposed risk mitigation, particularly if restrictions apply;

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The means by which legal certainty is to be established, including required documentation, supportive legal opinions and the steps needed to establish legal rights;

- Acceptable methodologies for initial and subsequent valuation of collateral, the frequency of valuation and the advance rates given;
- The actions it can take if the value of collateral or other mitigants is less than needed;
- The risk that the value of mitigants and counterparty credit quality may deteriorate simultaneously;
- The need to manage concentration risks arising from collateral types; and
- The need to ensure that any risk mitigation remains legally effective and enforceable.

The Group's business and credit teams are supported by specialist in-house documentation teams. The Group uses industry-standard loan and security documentation wherever possible. However, when the Group uses non-standard documentation, external lawyers are employed on a case-by-case basis.

*unaudited

Credit risk continued
Risk mitigation continued
Lending
The types of collateral the Group takes to mitigate the credit risk arising from wholesale lending varies according to the nature of the counterparty and its assets. The most common types are:

- Commercial real estate - The market value of the collateral typically exceeds the loan amount 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. In Ireland and, to a lesser extent, the UK, a lack of market data has made estimating the value of property difficult and so causes the Group to use a range of other types of information to value such collateral, including expert judgement and indices. For further information, regarding the Group's commercial real estate portfolio refer to pages 247 to 252.

- Residential property - The Group takes collateral in the form of residential property to mitigate the credit risk arising from mortgages and home equity lending. The Group values residential property during the loan underwriting process by either appraising properties individually or using statistically valid models. The Group updates residential property values quarterly using the relevant residential property index, namely the Halifax Quarterly Regional House Price Index in the UK, the Case-Shiller Home Price Index in the US, the Central Statistics Office Residential Property Price Index in the ROI, and the Nationwide House Price Index in Northern Ireland.

- Physical assets - These may include stock, plant, equipment, machinery, vehicles, ships and aircraft. Such assets are suitable collateral only if the Group can identify, locate, and segregate them from other assets on which it does not have a claim. The Group values physical assets in a variety of different ways, depending on the type of asset concerned and may rely on balance sheet valuations in certain cases. In the US, the Group also takes collateral in the form of motor vehicles to mitigate the credit risk arising from automobile lending. The Group values new vehicles at cost and used ones at the relevant average trade-in value.

- Receivables - These are amounts owed to the Group's counterparties by their own customers. The Group values them after taking into account the quality of its counterparty's receivable management processes and excluding any that are past due.

All collateral is assessed case-by-case to ensure that it will retain its value independently of the provider. The Group monitors the value of the collateral and, if there is a shortfall, will seek additional collateral.

The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value ratio, which represents loan value before provisions relative to the value of the property financed.

Commercial real estate loan-to-value ratio	Ulster Bank			Rest of the Group			Group		
	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
2013									
<= 50%	124	23	147	7,884	262	8,146	8,008	285	8,293
> 50% and <= 70%	271	55	326	9,962	582	10,544	10,233	637	10,870

> 70% and <= 90%	282	89	371	3,699	1,272	4,971	3,981	1,361	5,342
> 90% and <= 100%	86	154	240	865	368	1,233	951	522	1,473
> 100% and <= 110%	121	212	333	690	627	1,317	811	839	1,650
> 110% and <= 130%	238	366	604	333	1,334	1,667	571	1,700	2,271
> 130% and <= 150%	102	438	540	267	1,161	1,428	369	1,599	1,968
> 150%	319	6,738	7,057	150	2,629	2,779	469	9,367	9,836
Total with LTVs	1,543	8,075	9,618	23,850	8,235	32,085	25,393	16,310	41,703
Minimal security (1)	6	3,144	3,150	54	13	67	60	3,157	3,217
Other (2)	144	1,351	1,495	5,230	933	6,163	5,374	2,284	7,658
Total	1,693	12,570	14,263	29,134	9,181	38,315	30,827	21,751	52,578
Total portfolio average LTV (3)	121%	376%	335%	61%	149%	84%	65%	261%	142%

For the notes to this table refer to the following page.

Business review Risk and balance sheet management

Credit risk continued
Risk mitigation continued

Commercial real estate loan-to-value ratio	Ulster Bank			Rest of the Group			Group		
	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m	Performing £m	Non-performing £m	Total £m
2012 (4)									
<= 50%	141	18	159	7,210	281	7,491	7,351	299	7,650
> 50% and <= 70%	309	58	367	12,161	996	13,157	12,470	1,054	13,524
> 70% and <= 90%	402	164	566	6,438	1,042	7,480	6,840	1,206	8,046
> 90% and <= 100%	404	137	541	1,542	2,145	3,687	1,946	2,282	4,228
> 100% and <= 110%	111	543	654	1,019	1,449	2,468	1,130	1,992	3,122
> 110% and <= 130%	340	619	959	901	1,069	1,970	1,241	1,688	2,929
> 130% and <= 150%	353	774	1,127	322	913	1,235	675	1,687	2,362
> 150%	1,000	7,350	8,350	595	1,962	2,557	1,595	9,312	10,907
Total with LTVs	3,060	9,663	12,723	30,188	9,857	40,045	33,248	19,520	52,768
Minimal security (1)	8	1,615	1,623	3	13	16	11	1,628	1,639
Other (2)	137	811	948	6,494	1,191	7,685	6,631	2,002	8,633
Total	3,205	12,089	15,294	36,685	11,061	47,746	39,890	23,150	63,040
Total portfolio average LTV (3)	136%	286%	250%	65%	125%	80%	71%	206%	122%
2011									
<= 50%	272	32	304	7,091	332	7,423	7,363	364	7,727
> 50% and <= 70%	479	127	606	14,105	984	15,089	14,584	1,111	15,695
> 70% and <= 90%	808	332	1,140	10,042	1,191	11,233	10,850	1,523	12,373
> 90% and <= 100%	438	201	639	2,616	1,679	4,295	3,054	1,880	4,934
> 100% and <= 110%	474	390	864	1,524	1,928	3,452	1,998	2,318	4,316
	527	1,101	1,628	698	1,039	1,737	1,225	2,140	3,365

> 110% and <= 130%									
> 130% and <= 150%	506	1,066	1,572	239	912	1,151	745	1,978	2,723
> 150%	912	7,472	8,384	433	2,082	2,515	1,345	9,554	10,899
Total with LTVs	4,416	10,721	15,137	36,748	10,147	46,895	41,164	20,868	62,032
Minimal security (1)	72	1,086	1,158	—	—	—	72	1,086	1,158
Other (2)	193	625	818	8,994	1,844	10,838	9,187	2,469	11,656
Total	4,681	12,432	17,113	45,742	11,991	57,733	50,423	24,423	74,846
Total portfolio average LTV (3)	120%	264%	222%	69%	129%	82%	75%	203%	116%

Notes:

(1) In 2012, the Group reclassified loans with limited (defined as LTV>1,000%) or non-physical security as minimal security, of which a majority were commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect the relevant asset quality and recovery profile.

(2) Other non-performing loans of £2.3 billion (2012 - £2.0 billion; 2011 - £2.5 billion) were subject to the Group's standard provisioning policies. Other performing loans of £5.4 billion (2012 - £6.6 billion; 2011 - £9.2 billion) included general corporate loans, typically unsecured, to commercial real estate companies, and major UK house builders in addition to facilities supported by guarantees. The credit quality of these exposures was consistent with that of the performing portfolio overall.

(3) Weighted average by exposure.

(4) 2012 LTV revised to reflect refinement to security value reporting implemented during 2013.

Corporate risk elements in lending and potential problem loans (excluding commercial real estate)	2013 Loans £m	2013 Provisions £m	2012 Loans £m	2012 Provisions £m	2011 Loans £m	2011 Provisions £m
Secured	7,686	4,347	9,936	4,704	7,782	3,369
Unsecured	2,496	1,685	1,894	1,170	2,712	1,836

Credit risk continued

Risk mitigation continued

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

	UK Retail			Ulster Bank			RBS Citizens (1)			W
Loan-to-value ratio	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2013										
<= 50%	26,392	313	26,705	2,025	170	2,195	4,669	98	4,767	3,400
> 50% and <= 70%	34,699	591	35,290	1,837	195	2,032	5,529	89	5,618	3,397
> 70% and <= 90%	28,920	854	29,774	2,326	288	2,614	5,553	110	5,663	1,337
> 90% and <= 100%	4,057	315	4,372	1,214	162	1,376	1,309	39	1,348	87
> 100% and <= 110%	1,790	182	1,972	1,302	182	1,484	752	22	774	87
> 110% and <= 130%	552	100	652	2,509	461	2,970	637	17	654	27
> 130% and <= 150%	37	5	42	2,202	549	2,751	183	5	188	4
> 150%	—	—	—	2,385	1,227	3,612	102	4	106	24
Total with LTVs	96,447	2,360	98,807	15,800	3,234	19,034	18,734	384	19,118	8,363
Other (2)	511	20	531	—	—	—	463	3	466	215
Total	96,958	2,380	99,338	15,800	3,234	19,034	19,197	387	19,584	8,578
Total portfolio average LTV (3)	62%	75%	62%	103%	130%	108%	67%	69%	67%	51%
Average LTV on new originations during the year (3)			67%			73%			68%	
2012										
<= 50%	22,306	327	22,633	2,182	274	2,456	4,167	51	4,218	3,905
> 50% and <= 70%	27,408	457	27,865	1,635	197	1,832	4,806	76	4,882	2,790
> 70% and <= 90%	34,002	767	34,769	2,019	294	2,313	6,461	114	6,575	1,080
	7,073	366	7,439	1,119	156	1,275	2,011	57	2,068	93

> 90% and <= 100%										
> 100% and <= 110%	3,301	290	3,591	1,239	174	1,413	1,280	43	1,323	69
> 110% and <= 130%	1,919	239	2,158	2,412	397	2,809	1,263	42	1,305	49
> 130% and <= 150%	83	26	109	2,144	474	2,618	463	14	477	16
> 150%	—	—	—	3,156	1,290	4,446	365	14	379	29
Total with LTVs	96,092	2,472	98,564	15,906	3,256	19,162	20,816	411	21,227	8,031
Other (2)	486	12	498	—	—	—	292	19	311	674
Total	96,578	2,484	99,062	15,906	3,256	19,162	21,108	430	21,538	8,705
Total portfolio average LTV (3)	66%	80%	67%	108%	132%	112%	75%	86%	75%	51%
Average LTV on new originations during the year (3)			65%			74%			64%	

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Credit risk continued
Risk mitigation continued

	UK Retail			Ulster Bank			RBS Citizens (1)		
	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total
Loan-to-value ratio	£m	£m	£m	£m	£m	£m	£m	£m	£m
2011									
<= 50%	21,537	285	21,822	2,568	222	2,790	4,745	49	4,794
> 50% and <= 70%	25,598	390	25,988	1,877	157	2,034	4,713	78	4,791
> 70% and <= 90%	33,738	671	34,409	2,280	223	2,503	6,893	125	7,018
> 90% and <= 100%	7,365	343	7,708	1,377	128	1,505	2,352	66	2,418
> 100% and <= 110%	3,817	276	4,093	1,462	130	1,592	1,517	53	1,570
> 110% and <= 130%	1,514	199	1,713	2,752	322	3,074	1,536	53	1,589
> 130% and <= 150%	60	15	75	2,607	369	2,976	626	28	654
> 150%	—	—	—	2,798	748	3,546	588	27	615
Total with LTVs	93,629	2,179	95,808	17,721	2,299	20,020	22,970	479	23,449
Other (2)	567	13	580	—	—	—	681	23	704
Total	94,196	2,192	96,388	17,721	2,299	20,020	23,651	502	24,153
Total portfolio average LTV (3)	67%	80%	67%	104%	125%	106%	76%	91%	77%
Average LTV on new originations during the year (3)			63%			74%			63%

Notes:
(1) Includes residential mortgages and home equity loans and lines (refer to page 255 for a breakdown of balances).
(2) Where no indexed LTV is held.
(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Counterparty credit risk
The Group mitigates counterparty credit risk arising from both derivatives and repurchase agreements through the use of netting, collateral and the use of market standard documentation.

The Group mitigates counterparty credit risk by netting amounts it owes to a counterparty against amounts the same counterparty owes to it, in accordance with relevant regulatory and internal policies. It generally does so only if it has a netting agreement in place as well as a legal opinion to the effect that the agreement is enforceable in the relevant jurisdictions.

Collateral generally takes the form of cash. In the case of repurchase agreements, collateral usually takes the form of debt and equity securities at the outset but if the value of collateral falls relative to that of the obligation, the Group may require additional collateral in the form of cash (variation margin). Industry standard documentation, such as master repurchase agreements and credit support annexes accompanied by legal opinion, is used for financial collateral taken as part of trading activities.

The Group limits counterparty credit exposures by setting limits which take into account the potential adverse movement of a counterparty credit exposure after adjusting the impact of netting and collateral where applicable.

	2013	2012	2011
Mitigation of counterparty credit risk	£bn	£bn	£bn
Reverse repurchase agreements	76.5	104.8	100.9
Securities received as collateral (1)	(76.4)	(104.7)	(98.9)
Derivative assets gross exposure	288.0	441.9	530.1
Counterparty netting	(242.8)	(373.9)	(441.6)
Cash collateral held	(24.3)	(34.1)	(37.2)
Securities received as collateral	(6.0)	(5.6)	(5.3)

Note:

(1) In accordance with normal market practice, at 31 December 2013 £63.7 billion (2012 - £100.7 billion; 2011 - £95.4 billion) had been resold or re-pledged as collateral for the Group's own transactions.

Credit risk continued
Early problem identification and problem debt management
Wholesale
Early problem identification
Each division has defined early warning indicators (EWIs) to identify customers experiencing financial difficulty, and to increase monitoring if needed. EWIs may be internal, such as a customer's bank account activity, or external, such as a publicly-listed customer's share price. If EWIs show a customer is experiencing potential or actual difficulty, divisional credit officers may decide to place it on the Watchlist.

Watchlist*
There are three Watch classifications - Amber, Red and Black - reflecting progressively deteriorating conditions. Watch Amber customers are performing customers who show early signs of potential financial difficulty, or have other characteristics that warrant closer monitoring. Watch Red customers are performing customers who show signs of declining creditworthiness which requires active management usually by the Global Restructuring Group (GRG). Watch Black customers include risk elements in lending and potential problem loans.

Once on the Watchlist, customers are subject to heightened scrutiny. Depending on the severity of the financial difficulty and the size of the exposure, the customer relationship strategy is reassessed by credit officers, by specialist units in divisions or by GRG. In more material cases, a forum of experienced credit, portfolio management and remedial management specialists in the divisions or GRG may reassess the customer relationship strategy. In accordance with Group-wide policies, a number of mandatory actions are taken, including a review of the customer's credit grade and facility and 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, imminent breach of covenant, challenging macroeconomic conditions, a late payment or the expectation of a missed payment.

For all Watch Red cases, the division is required to consult with GRG on whether the relationship should be transferred to GRG (for more information on GRG, refer to below). Watch Red customers that continue to be managed by the divisions tend to be those requiring subject matter expertise that is available in the divisions rather than in GRG.

At 31 December 2013, exposures to customers reported as Watchlist Red and managed in the divisions totalled £3.2 billion (2012 - £4.3 billion).

Remediation strategies available in the divisions include granting a 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 metrics of the customer, the market environment and the loan structure and security. For further information, refer to the Wholesale forbearance section below.

Other potential outcomes of the relationship review are to: take the customer off the Watchlist; offer additional lending and continue monitoring; transfer the relationship to GRG if appropriate; or exit the relationship altogether.

The following table shows a sector breakdown of CRA of Watch Red customers under GRG management:

	2013			2012			2011		
	Core	Non-Core	Total	Core	Non-Core	Total	Core	Non-Core	Total

Watch Red CRA by current exposure	£m	£m	£m	£m	£m	£m	£m	£m	£m
Property	3,178	1,841	5,019	5,605	4,377	9,982	6,561	6,011	12,572
Transport	1,791	456	2,247	2,238	478	2,716	1,159	2,252	3,411
Retail and leisure	1,092	237	1,329	1,542	432	1,974	1,528	669	2,197
Services	955	40	995	870	84	954	808	141	949
Other	2,312	804	3,116	3,087	1,177	4,264	1,952	916	2,868
Total	9,328	3,378	12,706	13,342	6,548	19,890	12,008	9,989	21,997

The decrease in Watch Red cases was driven predominantly by a lower flow of cases into GRG, repayments and movement of cases into Watch Black. The overall value of customers in default has however reduced during the year. For further information regarding the asset quality of the Group's portfolio refer to the Asset quality section on page 231.

Global Restructuring Group

GRG manages the Group’s wholesale problem debt portfolio in cases where its exposure to the customer exceeds £1 million. In addition, GRG provides a specialist credit function, the Strategy Management Unit, for distressed bilateral lending where the exposure is between £250,000 and £1 million. The primary function of GRG is to restore customers to an acceptable credit condition and minimise losses to the Group.

The factor common to all customers managed by GRG is that the Group’s exposure is outside risk appetite. Customers transferred to GRG typically show symptoms of significant financial difficulty, such as cash flow pressures, or show evidence that the management team has limited experience of managing a business in difficulty. In addition, a customer may be transferred to GRG if the Group is not provided with sufficient or reliable information on which to make decisions.

GRG relationship managers use their skill, experience and judgement to support customers through these difficulties while seeking to minimise losses to protect the Group’s capital.

*unaudited

Credit risk continued
Early problem identification and problem debt management continued
When the relationship is transferred, GRG conducts a detailed assessment of the viability of the business as well as the ability of management to deal with the causes of financial difficulty. Following GRG's initial file assessment and, if appropriate, wider due diligence with input from independent experts (sector experts, accountants and surveyors), various options are presented to the customer. A strategy is then agreed with the customer for dealing with the distressed loan.

The objective is to find a mutually acceptable solution, including repayment, refinancing or transfer to another bank if that is the customer's preferred option. Once a solution is found, management of the loans may be transferred back to the performing divisions. If the business is not viable and a turnaround is not possible, insolvency may be an option.

Wholesale forbearance
Definition
Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties.

Concessions granted where there is no evidence of financial difficulty, or where any changes to terms and conditions are within the Group's usual risk appetite (for a customer new to the Group), or reflect improving credit market conditions for the customer, are not considered forbearance.

A number of options are available to the Group. Such actions are tailored to the customer's individual circumstances. The aim of such actions is to restore the customer to financial health and to minimise risk to the Group. To ensure that forbearance is appropriate for the needs and financial profile of the customer, the Group applies minimum standards when assessing, recording, monitoring and reporting forbearance.

Types of wholesale forbearance
Wholesale forbearance may involve the following types of concessions:

- Payment concessions and loan rescheduling, including extensions in contractual maturity, may be granted to improve the customer's liquidity. Concessions may also be granted on the expectation that the customer's liquidity will recover when market conditions improve. In addition, they may be granted if the customer will benefit from access to alternative sources of liquidity, such as an issue of equity capital. These options are commonly used in commercial real estate transactions, particularly where a shortage of market liquidity rules out immediate refinancing and makes short-term collateral sales unattractive.

- Debt may be forgiven, or exchanged for equity, where the customer's business or economic environment means that it cannot meet obligations and where other forms of forbearance are unlikely to succeed. Debt forgiveness is commonly used for stressed leveraged finance transactions. These 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, strategy and debt level are viable, maintaining the business as a going concern is the preferred option, rather than realising the value of the underlying assets.

A temporary covenant waiver, a recalibration of covenants or a covenant amendment may be used to cure a potential or actual covenant breach. In return for this relief, the Group would seek to obtain a return commensurate with the risk that it is required to take. The increased return for the increased risk can be structured flexibly to take into account the customer's circumstances, for example increased margin on a cash or payment in kind basis, and/or deferred return instruments.

The contractual margin may be amended to bolster the customer’s day-to-day liquidity to help sustain the customer’s business as a going concern. This would normally be a short-term solution. As set out above, the Group would seek to obtain a return commensurate to the risk that it is required to take and this can be structured in the same ways set out above.

Loans may be forborne more than once, generally where a temporary concession has been granted and circumstances warrant another temporary or permanent revision of the loan’s terms. All customers are assigned a PD and related facilities a LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan’s amended terms. Where forbearance is no longer viable, the Group will consider other options such as the enforcement of security and/or insolvency proceedings.

The ultimate outcome of a forbearance 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 the Group holds collateral or other security interest and is entitled to enforce its rights, it may enforce its security or otherwise take ownership or control of the assets. The Group’s preferred strategy is to consider other possible options prior to exercising these rights.

- Insolvency - Where there is no suitable forbearance 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.

The data presented in the tables below include loans forborne during 2011, 2012 and 2013 which individually exceeded thresholds set at divisional level. The Group continues to refine its reporting processes for forborne loans and, as a result, in 2013, thresholds were reduced to range from nil to £3 million. During 2011 and 2012, these thresholds ranged from nil to £10 million. The proportion of the Watch and GRG population covered by these thresholds has changed over time as the thresholds have been reduced. In 2013, this was 90% (2012 - 84%).

As part of the Group’s ongoing review of forbearance reporting, the amounts shown as “Completed forbearance” relating to 2012 and 2013 now include loans granted covenant concessions only. These were disclosed by way of a note in 2012. While the Group considers these types of concessions qualitatively different from other forms of forbearance, they constitute a significant proportion of wholesale forbearance and were therefore included.

Business review Risk and balance sheet management

Credit risk continued

Early problem identification and problem debt management continued

The table below shows the value of loans (excluding loans where the Group has initiated recovery procedures) where forbearance was completed during the year, by sector and types.

	2013			2012			2011	
Wholesale forbearance during the year by sector	Performing	Non-performing	Provision coverage (1)	Performing	Non-performing	Provision Coverage(1)	Performing	Non-performing
	£m	£m	%	£m	£m	%	£m	£m
Property	1,759	4,802	60	3,365	3,899	16	2,166	3,215
Transport	1,016	229	34	1,174	130	23	771	670
Retail and leisure	455	390	37	732	113	34	331	433
Services	405	234	77	324	51	30	177	94
Other	670	510	27	1,575	550	40	773	731
	4,305	6,165	55	7,170	4,743	20	4,218	5,143

Forbearance arrangements

The table below analyses the incidence of the main types of wholesale forbearance arrangements by loan value.

	2013	2012	2011
Wholesale forbearance during the year by arrangement type (2)	%	%	%
Payment concessions and loan rescheduling	78	49	92
Other (3)	31	14	9
Covenant-only concessions	16	30	—
Forgiveness of all or part of the outstanding debt	9	21	33
Variation in margin	2	6	12

Notes:

(1) Provision coverage reflects impairment provision as a percentage of non-performing loans.

(2) The total exceeds 100% as an individual case can involve more than one type of arrangement.

(3) The main types of 'other' concessions include formal 'standstill' agreements and release of security.

Key points

- A number of refinements have been made in 2013 to the reporting of wholesale forbearance as explained below:
  - Change in reporting thresholds from £10 million to £3 million, increased forbearance reported by £1.7 billion.
  - During ongoing portfolio reviews, a number of facilities totalling £2.3 billion were identified which were being managed in accordance with an agreed forbearance strategy but where the forbearance had not been formally documented. These have been included in the tables above, which has led to an increase in completed forbearance for 2013 and a corresponding decrease in loans which are "in process" for the purpose of forbearance (in process loans are explained below).
  - Covenant only forbearance of £1.7 billion (2012 - £3.5 billion) has been included.
-

Year-on-year analysis of forborne loans may be skewed by individual material cases during a given year. This is particularly relevant when comparing the value of forbearance completed in the property and transport sectors in 2013 with previous years.

- At 31 December 2013, loans totalling £9.4 billion (2012 - £13.7 billion) were granted credit approval for forbearance but where such forbearance had not yet been formally documented and which were not being managed in accordance with an agreed forbearance strategy. These loans are referred to as in process and are not included in the tables above. 84% of these were non-performing loans, with an associated provision coverage of 44%, and 16% were performing loans. The principal types of arrangements offered included payment concessions and loan rescheduling, covenant concessions, forgiveness of all or part of the outstanding debt and variations in margin.

- Loans forborne during 2012 and 2013 and outstanding at 31 December 2013 totalled £18.4 billion, of which £8.0 billion related to arrangements completed during 2012.

- Core bank customers were granted forbearance by GRG on loan facilities totalling £6.9 billion during 2012 and 2013, which equates to 23% of loans managed by GRG (excluding loans to customers managed by recovery units). Of these loans, 15% by value had been returned to performing portfolios managed within the originating divisions by 31 December 2013. There are also loans that are not forborne which have been returned from GRG to performing portfolios managed within the originating divisions. 79% by value of the performing Core loans granted forbearance during 2012 remained performing as at 31 December 2013.*

- Provision coverage for forborne loans increased during the year. This was primarily the result of provisions in Ulster Bank, specifically in the property sector, and driven by the Group's RCR strategy. For further information regarding Ulster Bank refer to the Ulster Bank Group (Core and Non-Core) section on pages 260 to 262.

*unaudited

Credit risk continued
Early problem identification and problem debt management continued
Retail
Collections
Collections functions in each of the Group's retail businesses provide support and assistance to customers who are experiencing difficulties in meeting their obligations to the Group. Such customers may miss a payment on their loan or borrow more than their agreed limit, or contact the Group themselves asking for help. Dedicated support teams are also in place to identify and help customers who have not yet missed a payment but may be facing financial difficulty.

The collections function may use a range of tools to initiate contact with the customer, establish the cause of their financial difficulty and support them where possible. In the process, they may consider granting the customer forbearance.

Additionally, in the UK and Ireland, support is provided to customers with unsecured loans who establish a repayment plan with the Group through a debt advice agency or a self-help tool. Such "breathing space" suspends collections activity for a 30-day period to allow time for the repayment plan to be put in place. Arrears continue to accrue for customer loans granted breathing space.

If collections strategies are unsuccessful the relationship is transferred to the recoveries team. For further details on recoveries, refer to page 245.

Retail forbearance
Definition
Forbearance takes place when a concession is made on the contractual terms of a loan in response to a customer's financial difficulties. In UK Retail and Ulster Bank, a broader definition of forbearance is used that includes mortgages where a customer has made a change to contractual terms, when their payments status is up-to-date and they are not necessarily evidencing signs of financial difficulty. Forbearance is granted on a permanent, or temporary, basis following an assessment of the customer's individual circumstances and ability to pay. For UK Retail and Ulster Bank, the disclosure covers changes in contractual terms dating back to January 2008 and early 2009 respectively.

Identification
Customers who contact the bank directly because of financial difficulties, or who are already in payment arrears, may be granted forbearance. In the course of assisting customers, more than one forbearance treatment may be granted.

Types of retail forbearance
Forbearance is granted principally to customers with mortgages and less extensively to customers with unsecured loans.

Mortgage portfolios
Forbearance options include, but are not limited to, payment concessions, capitalisations of arrears, term extensions and temporary conversions to interest only.

- Payment concessions - A temporary reduction in, or elimination of, the periodic (usually monthly) loan repayment is agreed with the customer. At the end of the concessionary period, forborne principal and accrued interest outstanding is scheduled for repayment over an agreed period. Ulster Bank and RBS Citizens also offer payment concessions in the form of discounted interest rates that involve the forgiveness of some interest (further details below).

- Capitalisation of arrears - The customer repays the arrears over the remaining term of the mortgage and returns to an up-to-date position.
- Term extensions - The maturity date of the loan is extended.
- Interest only conversions - The loan converts from principal and interest repayment to interest only repayment on a temporary basis (Ulster Bank only).

In UK Retail, interest only conversions have not been used to support customers in financial difficulty since 2009, and from 2012 have only been permitted on a very exceptional basis for residential mortgage customers who are up to date on payments. As a result interest only loans with permanent changes to terms are historical stock. In Ulster Bank, interest only conversions are offered to customers under financial stress and solely on a temporary basis.

In response to the economic difficulties in the Republic of Ireland, Ulster Bank has developed additional forbearance options. These payment concessions support customers over an extended period of time and include instances where some interest is forgiven by granting interest rate discounts for a 3-5 year period.

Similarly RBS Citizens participates in the US government mandated Home Affordable Modification Program as well as its own proprietary programme. Both feature a combination of term extensions, capitalisations of arrears, interest rate reductions and conversions from interest only to amortising. These tend to be permanent changes to contractual terms. In order to qualify for either of the programmes, customers must meet government-specified or internal criteria designed to evidence financial difficulty but demonstrate a willingness to pay.

Credit risk continued
Early problem identification and problem debt management continued
Unsecured portfolios
For unsecured portfolios in UK Retail and Ulster Bank, forbearance entails reduced or deferred payments. Arrangements to facilitate the repayment of overdraft excesses or loan arrears can be agreed dependent on affordability. Where repayment arrangements are not affordable debt consolidation loans can be provided to customers in collections.

In RBS Citizens, granting of forbearance is predominantly restricted to short-term (1-3 months) loan extensions to alleviate the financial burden caused by temporary hardship. Such extensions are offered only if a customer has demonstrated a capacity and willingness to pay. The number and frequency of extensions granted to a customer are limited. Additionally, for loans secured by vehicles and credit cards, RBS Citizens may offer temporary interest rate modifications, but no principal reductions. Forbearance may also be offered to student loan customers consistent with the policy guidelines of the US Office of the Comptroller of the Currency.

- For unsecured portfolios in UK Retail, £121 million of balances (1% of the total unsecured balances) were subject to forbearance at 2013 year end.

- For unsecured portfolios in Ulster Bank, £16 million (3.8% by value) of the population was subject to forbearance at 31 December 2013.

- For unsecured portfolios in RBS Citizens, £135 million (1.7% of the unsecured balances) were subject to forbearance at 2013 year end (includes auto and recreational vehicle marine portfolios and excludes small business loans as these are included as part of wholesale reporting).

Monitoring of forbearance
Forbearance loans may be performing or non-performing. The granting of forbearance does not change the delinquency status of the loan unless the arrangement involves a capitalisation of all existing arrears of principal and interest, in which case the loan becomes up-to-date.

Loans granted forbearance are included in the non-performing book: when 90 days past due; or if the forbearance arrangement is a payment concession that involves a reduction in contractually required cash flows i.e. the forgiveness of interest. Such loans are classified as impaired. In RBS Citizens, all loans subject to forbearance are included in the non-performing book.

There are instances when loans subject to forbearance are transferred from the non-performing book to the performing book. In UK Retail, when arrears are capitalised, a loan is transferred to the performing book once the borrower has met the revised payment terms for at least six months and is expected to continue to do so. In addition, a small portfolio of loans past due 90 days are managed by UK Retail's collections function. Loans in this portfolio may also be transferred to the performing book if the customer makes payments that reduce arrears below 90 days.

In Ulster Bank, if a customer makes payments that reduce loan arrears below 90 days, the loan is transferred to the performing book. In addition, where a customer meets the original payment terms for six months and is expected to continue to do so, capitalisation may be agreed. In these cases the loan is also transferred to the performing book.

Mortgages granted forbearance are reviewed regularly to ensure that customers are meeting the agreed terms. Key metrics have been developed to record the proportion of loans that fail to meet the agreed terms over time, as well as the proportion of loans that return to performing with no arrears. Retail forbearance loans can be modified more than once.

Twelve month default rates are calculated for all mortgage forbearance types. In 2013, the average twelve month default rates were 8% for UK Retail, 18% for Ulster Bank and 13% for RBS Citizens.

Credit risk continued
Early problem identification and problem debt management continued
Arrears status and provisions
The mortgage arrears information for retail accounts in forbearance and related provision are shown in the tables below.

	No missed payments		1-3 months in arrears		>3 months in arrears		Total		
	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Balance £m	Provision £m	Forborne balances (1) %
2013									
UK Retail (2,3)	4,596	17	426	23	424	51	5,446	91	5.5
Ulster Bank (2,3)	1,362	166	631	76	789	323	2,782	565	14.6
RBS Citizens	287	26	33	3	53	—	373	29	1.9
Wealth	112	3	6	—	9	—	127	3	1.5
	6,357	212	1,096	102	1,275	374	8,728	688	6.0
2012									
UK Retail (2,3)	4,006	20	388	16	450	64	4,844	100	4.9
Ulster Bank (2,3)	915	100	546	60	527	194	1,988	354	10.4
RBS Citizens	—	—	179	25	160	10	339	35	1.6
Wealth	38	—	—	—	7	—	45	—	0.5
	4,959	120	1,113	101	1,144	268	7,216	489	4.9
2011									
UK Retail (2,3)	3,677	16	351	13	407	59	4,435	88	4.7
Ulster Bank (2,3)	893	78	516	45	421	124	1,830	247	9.1
RBS Citizens	—	—	91	10	89	10	180	20	0.8
Wealth	121	—	—	—	2	—	123	—	1.3
	4,691	94	958	68	919	193	6,568	355	4.4

Notes:
(1) As a percentage of mortgage loans.
(2) Forbearance in UK Retail and Ulster Bank capture all instances where a change has been made to the contractual payment terms including those where the customer is up-to-date on payments and there is no obvious evidence of financial difficulty.
(3) Includes the current stock position of forbearance deals agreed since early 2008 for UK Retail and early 2009 for Ulster Bank.

Credit risk continued
Early problem identification and problem debt management continued
Forbearance arrangements
The incidence of the main types of retail forbearance on the balance sheet are analysed below.

2013	UK Retail £m	Ulster Bank £m	RBS Citizens £m	Wealth £m	Total (1) £m
Interest only conversions - temporary and permanent (2)	1,784	512	—	—	2,296
Term extensions - capital repayment and interest only	2,478	325	35	29	2,867
Payment concessions (3)	241	1,567	246	12	2,066
Capitalisation of arrears	907	494	—	—	1,401
Other	366	—	92	86	544
	5,776	2,898	373	127	9,174
2012					
Interest only conversions - temporary and permanent	1,220	924	—	6	2,150
Term extensions - capital repayment and interest only	2,271	183	—	27	2,481
Payment concessions (3)	215	762	339	9	1,325
Capitalisation of arrears	932	119	—	—	1,051
Other	452	—	—	3	455
	5,090	1,988	339	45	7,462
2011					
Interest only conversions - temporary and permanent	1,269	795	—	3	2,067
Term extensions - capital repayment and interest only	1,805	58	—	97	1,960
Payment concessions	198	876	180	—	1,254
Capitalisation of arrears	864	101	—	—	965
Other	517	—	—	23	540
	4,653	1,830	180	123	6,786

Notes:
(1) As an individual case can include more than one type of arrangement, the analysis in the table on forbearance arrangements exceeds the total value of cases subject to forbearance.
(2) The year-on-year increase for UK Retail was driven by an extension of the reporting definition to include legacy conversions to interest only repayment in cases where customers were previously on a combination of repayment types.
(3) Includes £365 million of Ulster Bank loans (2012 - £10 million) and £62 million of RBS Citizens loans (2012 - £31 million) where an interest rate discount has been agreed resulting in a reduction of contractual cash flows through forgiveness of interest.

The table below shows forbearance agreed during the year analysed between performing and non-performing.

2013	UK Retail £m	Ulster Bank £m	RBS Citizens £m	Wealth £m	Total £m
Performing forbearance	1,332	2,223	—	41	3,596

Non-performing forbearance	186	1,213	101	22	1,522
Total forbearance (1,2)	1,518	3,436	101	63	5,118
2012					
Performing forbearance	1,809	2,111	88	18	4,026
Non-performing forbearance	184	1,009	71	2	1,266
Total forbearance (1,2)	1,993	3,120	159	20	5,292

Notes:

(1) An individual case can include more than one type of arrangement.

(2) Includes all arrangements agreed during the year (new customers and renewals) including those deals that have expired at year end. Balances are at year end.

Credit risk continued

Early problem identification and problem debt management continued

Key points

UK Retail

- At 31 December 2013, forbearance balances where the forbearance treatment was provided in the last 24 months amounted to £2.0 billion. This represented a 14% reduction in the year.

- The flow of new forbearance of £380 million in the fourth quarter of 2013 continued on a downward trend compared with an average of £456 million in the preceding four quarters. The full year flow for 2013 was £1.7 billion, a 15% reduction on the 2012 flow.

- 5.5% of total mortgage assets (£5.4 billion) were subject to a forbearance arrangement agreed since January 2008. This represented an increase from 4.9% on 2012 (£4.8 billion). The rise was driven by an extension of the reporting definition to include legacy conversions to interest only repayment in cases where customers were previously on a combination of repayment types. Excluding this change in definition, forbearance stock remained stable.

- Approximately 84% of forbearance loans (2012 - 83%) were up to date with payments compared with approximately 97% of assets not subject to forbearance activity.

- The majority (90%) of UK Retail forbearance is permanent in nature (term extensions, capitalisation of arrears, historic conversions to interest only). Temporary forbearance comprises payment concessions such as reduced or deferred payments with such arrangements typically agreed for a period of three to six months.

- The most frequently occurring forbearance types were term extensions (43% of forbearance loans at 31 December 2013), interest only conversions (31%) and capitalisations of arrears (16%). The growth of interest only stock reflected the extended definition referred to above. The underlying level of transfers was negligible and the remaining stock was the result of legacy policy. Conversions to interest only have only been permitted on a very exceptional basis since the fourth quarter of 2012 and have not been permitted for customers in financial difficulty since 2009.

- The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance.

Ulster Bank

- At 31 December 2013, 14.6% of total mortgage assets (£2.8 billion) were subject to a forbearance arrangement (agreed since early 2009), an increase from 10.4% (£2.0 billion) at 31 December 2012. This reflected Ulster Bank's proactive strategies to contact customers in financial difficulty to offer assistance.

- Although the forbearance stock increased by 40% during the year, the number of customers approaching Ulster Bank for assistance for the first time remained broadly stable. This can be attributed to more mortgages being put on to longer-term arrangements, and therefore not exiting forbearance.

- The majority of forbearance arrangements were less than 90 days in arrears (72%).

- The mix of forbearance treatments in Ulster Bank changed with an increase in longer-term solutions. A total of 28% of forbearance loans were subject to a permanent arrangement at 31 December 2013 (2012 - 15%). Capitalisations represented 17% and term extensions represented 11% of the forbearance portfolio at 31 December 2013, increasing from 6% and 9% respectively.

- The remaining forbearance loans were temporary concessions accounting for 72%. Short to medium-term concessions are offered for periods of three months to five years and incorporate different levels of repayment based on the customer's ability to pay.

- Temporary interest only arrangements decreased during 2013 to 18% of forbearance loans at 31 December 2013 (2012 - 46%). This reflected Ulster Bank's strategy to transition customers in financial difficulty to long-term arrangements.

- Payment concessions represented the remaining 54%, comprising: deals where payments amortised the outstanding balance (41%); a diminishing portfolio of deals that negatively amortised (10%); and payment holidays (3%).

- The impairment provision cover on forbearance loans remained significantly higher than that on assets not subject to forbearance.

Credit risk continued
Early problem identification and problem debt management continued
Recoveries
Once a loan has been identified as impaired it is managed by divisional recoveries functions. Their goal is to collect the total outstanding and reduce the Group's loss by maximising cash recovery while treating customers fairly. Where an acceptable repayment arrangement cannot be agreed with the customer, litigation may be considered. In UK Retail and Northern Ireland, no repossession procedures are initiated until at least six months following the emergence of arrears. In the Republic of Ireland, new regulations prohibit taking legal action for an extended period. Additionally, certain forbearance options are made available to customers managed by the recoveries function.

Group impairment loss provisioning
Impaired definition
A financial asset is impaired 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 it. The loss is measured as the difference between the carrying value of the loan and the present value of estimated future cash flows discounted at the loan's original effective interest rate.

For both wholesale and retail exposures, days-past-due measures are typically used to identify evidence of impairment. In both corporate and retail portfolios, a period of 90 days past due is used. In sovereign portfolios, the period used is 180 days past due. Other factors are considered including: the borrower's financial condition; a forbearance event; a loan restructuring; the probability of bankruptcy; or any evidence of diminished cash flows.

Provisioning methodology
If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset carrying amount and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. The current net realisable value of the collateral will be taken into account in determining the need for a provision. No impairment provision is recognised in cases where amounts due are expected to be settled in full on realisation of the security. The Group uses one of the following three different methods to assess the amount of provision required: individual; collective; and latent.

Individually assessed provisions
Loans and securities above a defined threshold deemed to be individually significant are assessed on a case-by-case basis. Assessments of future cash flows take into account the impact of any guarantees or collateral held. Projections of cash flow receipts are based on the Group's judgement and facts available at the time. Projected cash flows are reviewed on subsequent assessment dates as new information becomes available.

Collectively assessed provisions
Provisions on impaired credits below an agreed threshold are assessed on a portfolio basis, reflecting the homogeneous nature of the assets. The Group segments wholesale and retail portfolios according to product type, such as credit cards, personal loans and mortgages. The approach taken to assess impaired assets in collections differs from the approach taken to assess those in recoveries (refer to page 240 for further details on collections and refer to above for recoveries).

Provisions are determined based on a quantitative review of the relevant portfolio. They take account of the level of arrears, the value of any security, and historical and projected cash recovery trends over the recovery period. The provisions also incorporate any adjustments that may be deemed appropriate given current economic conditions. Such adjustments may be determined based on a review of the latest cash collections profile and operational processes used in managing exposures.

Latent loss provisions
In the performing portfolio, latent loss provisions are held against losses incurred but not identified before the balance sheet date. Latent loss provisions reflect PDs and LGDs as well as emergence periods. The emergence period is defined as the period between the occurrence of the impairment event 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 coupon period and repayment terms, and the duration of the administrative process required to report and identify an impaired loan as such. Emergence periods vary across different portfolios from 2 to 225 days. They are based on actual experience within the particular portfolio and are reviewed regularly.

The Group's retail businesses segment their performing loan books into homogeneous portfolios such as mortgages, credit cards or unsecured loans, to reflect their different credit characteristics. Latent provisions are computed by applying portfolio level LGDs, PDs and emergence periods. The wholesale calculation is based on similar principles but there is no segmentation into portfolios. PDs and LGDs are calculated on an individual basis.

Refer to pages 294 to 312 for analysis of impaired loans, related provisions and impairments.

Credit risk: Early problem identification and problem debt management continued
Impact of forbearance on provisioning
Wholesale
Forbearance may result in the value of the outstanding debt exceeding the present value of the estimated future cash flows. This may result in the recognition of an impairment loss or a write-off.

Provisions for forborne wholesale loans are assessed in accordance with the Group's normal provisioning policies (refer to Group impairment loss provisioning on page 245). The customer's financial position and prospects as well as the likely effect of the forbearance, including any concessions granted, are considered in order to establish whether an impairment provision is required. Individual impairment assessments for wholesale loans are reassessed in the light of any revisions to the loan's terms.

All wholesale customers are assigned a PD and related facilities an LGD. These are re-assessed prior to finalising any forbearance arrangement in light of the loan's amended terms and any revised grading incorporated in the calculation of the impairment loss provisions for the Group's wholesale exposures.

For performing counterparties, credit metrics are an integral part of the latent provision methodology and therefore the impact of covenant concessions will be reflected in the latent provision. For non-performing loans, covenant concessions will be considered in the overall provision adequacy for these loans.

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

The transfer of wholesale loans subject to forbearance 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.

Retail
Provisions are assessed in accordance with the Group's provisioning policies (refer to Group impairment loss provisioning on page 245).

Impairment provisions in respect of loans subject to forbearance are evaluated as follows:

In UK Retail performing loans are subject to a latent loss provision but form a separate risk pool for 24 months. The higher of the observed default rates and PDs are used in the latent provisioning calculations for these loans to ensure that appropriate provision is held. Furthermore, for these portfolios the latent provision incorporates extended emergence periods. Once such loans are no longer separately identified, the use of account level PDs refreshed monthly in the latent provision methodology captures the underlying credit risk without a material time lag.

There is no reassessment of the PD at the time forbearance is granted but the loan will be the subject to the latent provisioning methodology described above. Non-performing loans are subject to a collectively assessed provision methodology.

In Ulster Bank performing loans are subject to a latent loss provision but form a separate risk pool for the period of forbearance. The performance of forbearance arrangements is analysed and breakage (a single missed payment) rates computed. The higher of the breakage rate and the modelled PD for this separate risk pool is used when calculating the latent provision. Furthermore, for this portfolio the latent provision incorporates an extended emergence period. Once such loans are no longer separately identified, the use of account level PDs refreshed monthly in the latent provision methodology captures the underlying credit risk without a material time lag. There is no reassessment of the PD at the time forbearance is granted but the loan will be the subject to the latent provisioning methodology described above. Non-performing loans are subject to a collectively assessed provision methodology. However, loans not 90 days past due that are subject to forbearance arrangements involving a reduction in contractually required cash flows i.e. the forgiveness of interest and where arrears have not been capitalised are classified as non-performing. They form a separate risk pool for the period of forbearance and the related loan loss provision is computed using Ulster Bank's latent loss provision methodology.

Non-performing loans are grouped into homogeneous portfolios sharing similar credit characteristics according to the asset type. Further characteristics such as LTVs, arrears status and default vintage are also considered when assessing recoverable amount and calculating the related provision requirement. While non-performing forbearance retail loans do not form a separate risk pool, the LGD models used to calculate the collective impairment provision are affected by agreements made under forbearance arrangements.

In RBS Citizens, retail loans subject to forbearance are segmented from the rest of the non-forborne population and assessed individually for impairment loss throughout their lives until the loans are repaid or fully written off. The amount of recorded impairment depends on whether the loan is collateral dependent. If the loans are considered collateral dependent, the excess of the loan's carrying amount over the fair value of the collateral is the impairment amount. If the loan is not deemed collateral dependent, the excess of the loans' carrying amount over the present value of expected future cash flows is the impairment amount. Any confirmed losses are charged off immediately.

Write-offs

The Group normally writes-off loans when it has exhausted all its collection strategies and has no realistic chance of recovering the money it is owed. Refer to pages 374 and 375 for further information on the Group's write-off policies and practices.

Credit risk continued

Key loan portfolios*

Commercial real estate

The commercial real estate sector comprised exposures to entities involved in the development of, or investment in, commercial and residential properties (including house builders). The analysis of lending utilisations below is gross of impairment provisions and excludes rate risk management and contingent obligations.

	2013			2012			2011		
Commercial real estate by division (1)	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m	Investment £m	Development £m	Total £m
Core									
UK Corporate	20,547	3,467	24,014	22,504	4,091	26,595	25,101	5,023	30,124
Ulster Bank	3,419	718	4,137	3,575	729	4,304	3,882	881	4,763
US Retail & Commercial	4,018	—	4,018	3,857	3	3,860	4,235	70	4,305
International Banking	762	182	944	849	315	1,164	872	299	1,171
Markets	136	1	137	630	57	687	141	61	202
	28,882	4,368	33,250	31,415	5,195	36,610	34,231	6,334	40,565
Non-Core									
UK Corporate	1,201	774	1,975	2,651	983	3,634	3,957	2,020	5,977
Ulster Bank	3,211	6,915	10,126	3,383	7,607	10,990	3,860	8,490	12,350
US Retail & Commercial	232	—	232	392	—	392	901	28	929
International Banking	6,980	15	6,995	11,260	154	11,414	14,689	336	15,025
	11,624	7,704	19,328	17,686	8,744	26,430	23,407	10,874	34,281
	40,506	12,072	52,578	49,101	13,939	63,040	57,638	17,208	74,846

	Investment		Development			Investment		Development		
Commercial real estate by geography (1)	Commercial £m	Residential £m	Commercial £m	Residential £m	Total £m	Core £m	Non-Core £m	Core £m	Non-Core £m	Total £m
2013										
UK (excluding NI (2))	20,862	5,007	678	3,733	30,280	21,297	4,572	3,500	911	30,280
Ireland (ROI and NI (2))	4,405	1,028	1,919	5,532	12,884	2,763	2,670	686	6,765	12,884
	4,068	183	22	17	4,290	223	4,028	11	28	4,290

Western Europe (other)										
US	3,563	1,076	—	8	4,647	4,313	326	8	—	4,647
RoW (2)	314	—	30	133	477	286	28	163	—	477
	33,212	7,294	2,649	9,423	52,578	28,882	11,624	4,368	7,704	52,578
2012										
UK (excluding NI (2))	25,864	5,567	839	4,777	37,047	23,312	8,119	4,184	1,432	37,047
Ireland (ROI and NI (2))	4,651	989	2,234	5,712	13,586	2,877	2,763	665	7,281	13,586
Western Europe (other)	5,995	370	22	33	6,420	403	5,962	24	31	6,420
US	4,230	981	—	15	5,226	4,629	582	15	—	5,226
RoW (2)	454	—	65	242	761	194	260	307	—	761
	41,194	7,907	3,160	10,779	63,040	31,415	17,686	5,195	8,744	63,040
2011										
UK (excluding NI (2))	28,653	6,359	1,198	6,511	42,721	25,904	9,108	5,118	2,591	42,721
Ireland (ROI and NI (2))	5,146	1,132	2,591	6,317	15,186	3,157	3,121	793	8,115	15,186
Western Europe (other)	7,649	1,048	9	52	8,758	422	8,275	20	41	8,758
US	5,552	1,279	59	46	6,936	4,521	2,310	71	34	6,936
RoW (2)	785	35	141	284	1,245	227	593	332	93	1,245
	47,785	9,853	3,998	13,210	74,846	34,231	23,407	6,334	10,874	74,846

For the notes to these tables refer to the following page.

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Credit risk continued

Key loan portfolios* continued

Commercial real estate by sub-sector (1)	UK (excl NI (2)) £m	Ireland (ROI and NI (2)) £m	Western Europe £m	US £m	RoW (2) £m	Total £m
2013						
Residential	8,740	6,560	200	1,085	133	16,718
Office	4,557	813	1,439	32	121	6,962
Retail	6,979	1,501	967	84	73	9,604
Industrial	3,078	454	43	30	13	3,618
Mixed/other	6,926	3,556	1,641	3,416	137	15,676
	30,280	12,884	4,290	4,647	477	52,578
2012						
Residential	10,344	6,701	403	996	242	18,686
Office	6,112	1,132	1,851	99	176	9,370
Retail	7,529	1,492	1,450	117	129	10,717
Industrial	3,550	476	143	4	39	4,212
Mixed/other	9,512	3,785	2,573	4,010	175	20,055
	37,047	13,586	6,420	5,226	761	63,040
2011						
Residential	12,870	7,449	1,100	1,325	319	23,063
Office	7,155	1,354	2,246	404	352	11,511
Retail	8,709	1,641	1,891	285	275	12,801
Industrial	4,317	507	520	24	105	5,473
Mixed/other	9,670	4,235	3,001	4,898	194	21,998
	42,721	15,186	8,758	6,936	1,245	74,846

Notes:

(1) Excludes commercial real estate lending in Wealth as these loans are generally supported by personal guarantees in addition to collateral. This portfolio, which totalled £1.4 billion at 31 December 2013 (2012 - £1.4 billion; 2011 - £1.3 billion) continued to perform in line with expectations and required minimal provision.

(2) ROI: Republic of Ireland; NI: Northern Ireland; RoW: Rest of World.

Key points

- In line with Group strategy, the overall gross lending exposure to commercial real estate (CRE) fell by £10.5 billion, or 17%, during 2013 to £52.6 billion. Gross lending exposure is now almost half of the exposure of four years ago. The overall mix of geography, sub-sector and investment and development remained broadly unchanged.

- A significant proportion of the decrease was in Non-Core and was due to repayments, asset sales and write-offs. The Non-Core portfolio totalled £19.3 billion (37% of the portfolio) at 31 December 2013 (2012 - £26.4 billion or 42% of the portfolio).

- The UK portfolio was focused on London and South East England. Approximately 47% of the portfolio was held in these areas at 31 December 2013 (2012 - 43%).

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Business review Risk and balance sheet management

Credit risk continued
Key loan portfolios* continued

Commercial real estate maturity profile of portfolio	UK Corporate £m	Ulster Bank £m	US Retail & Commercial £m	International Banking £m	Markets £m	Total £m
2013						
Core						
< 1 year (1)	6,816	2,740	602	352	117	10,627
1-2 years	3,436	360	669	203	—	4,668
2-3 years	4,721	177	739	116	7	5,760
> 3 years	8,621	860	2,008	273	13	11,775
Not classified (2)	420	—	—	—	—	420
	24,014	4,137	4,018	944	137	33,250
Non-Core						
< 1 year (1)	1,432	8,479	85	4,864	—	14,860
1-2 years	77	1,276	31	507	—	1,891
2-3 years	36	185	33	220	—	474
> 3 years	295	186	83	1,404	—	1,968
Not classified (2)	135	—	—	—	—	135
	1,975	10,126	232	6,995	—	19,328
2012						
Core						
< 1 year (1)	8,639	3,000	797	216	59	12,711
1-2 years	3,999	284	801	283	130	5,497
2-3 years	3,817	215	667	505	—	5,204
> 3 years	9,597	805	1,595	160	498	12,655
Not classified (2)	543	—	—	—	—	543
	26,595	4,304	3,860	1,164	687	36,610
Non-Core						
< 1 year (1)	2,071	9,498	138	4,628	—	16,335
1-2 years	192	1,240	79	3,714	—	5,225
2-3 years	99	38	43	1,137	—	1,317
> 3 years	1,058	214	132	1,935	—	3,339
Not classified (2)	214	—	—	—	—	214
	3,634	10,990	392	11,414	—	26,430
2011						
Core						
< 1 year (1)	8,268	3,030	1,056	142	—	12,496
1-2 years	5,187	391	638	218	60	6,494
2-3 years	3,587	117	765	230	133	4,832
> 3 years	10,871	1,225	1,846	581	9	14,532
Not classified (2)	2,211	—	—	—	—	2,211
	30,124	4,763	4,305	1,171	202	40,565

Non-Core						
< 1 year (1)	3,224	11,089	293	7,093	—	21,699
1-2 years	508	692	163	3,064	—	4,427
2-3 years	312	177	152	1,738	—	2,379
> 3 years	1,636	392	321	3,126	—	5,475
Not classified (2)	297	—	—	4	—	301
	5,977	12,350	929	15,025	—	34,281

Notes:

(1) Includes on demand and past due assets.

(2) Predominantly comprises overdrafts and multi-option facilities for which there is no single maturity date.

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Credit risk continued
Key loan portfolios* continued
Key points

- The overall maturity profile remained relatively unchanged during 2013.

- The majority of Ulster Bank's commercial real estate portfolio was categorised as under one year, owing to the high level of non-performing assets in the portfolio.

Commercial real estate portfolio by asset quality band	AQ1-AQ2 £m	AQ3-AQ4 £m	AQ5-AQ6 £m	AQ7-AQ8 £m	AQ9 £m	AQ10 £m	Total £m
2013							
Core	441	7,801	13,396	5,199	665	5,748	33,250
Non-Core	—	376	1,433	1,341	176	16,002	19,328
	441	8,177	14,829	6,540	841	21,750	52,578
2012							
Core	767	6,011	16,592	6,575	1,283	5,382	36,610
Non-Core	177	578	3,680	3,200	1,029	17,766	26,430
	944	6,589	20,272	9,775	2,312	23,148	63,040
2011							
Core	1,094	6,714	19,054	6,254	3,111	4,338	40,565
Non-Core	680	1,287	5,951	3,893	2,385	20,085	34,281
	1,774	8,001	25,005	10,147	5,496	24,423	74,846

Key points

- There was an overall decrease in AQ10 during the year with reductions in Non-Core partially offset by increases in Ulster Bank. The high proportion of the portfolio in AQ10 was driven by exposure in Non-Core (Ulster Bank and International Banking) and Core (Ulster Bank).

- Of the total portfolio of £52.6 billion at 31 December 2013, £24.9 billion (2012 - £28.1 billion) was managed within the Group's standard credit processes. Another £2.9 billion (2012 - £5.1 billion) received varying degrees of heightened credit management under the Watchlist process. The decrease in the portfolio managed in the Group's Watchlist process occurred mainly in Non-Core and UK Corporate. The remaining £24.7 billion (2012 - £29.8 billion) was managed in GRG and included Watchlist and non-performing exposures.

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Business review Risk and balance sheet management

Credit risk continued
Key loan portfolios* continued
The table below analyses commercial real estate (Core and Non-Core) lending by loan-to-value ratio, which represents loan value before provisions relative to the value of the property financed.

	Ulster Bank			Rest of the Group			Group		
Commercial real estate loan-to-value ratio	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Tota
	£m	£m	£m	£m	£m	£m	£m	£m	£n
2013									
<= 50%	124	23	147	7,884	262	8,146	8,008	285	8,29
> 50% and <= 70%	271	55	326	9,962	582	10,544	10,233	637	10,87
> 70% and <= 90%	282	89	371	3,699	1,272	4,971	3,981	1,361	5,34
> 90% and <= 100%	86	154	240	865	368	1,233	951	522	1,47
> 100% and <= 110%	121	212	333	690	627	1,317	811	839	1,65
> 110% and <= 130%	238	366	604	333	1,334	1,667	571	1,700	2,27
> 130% and <= 150%	102	438	540	267	1,161	1,428	369	1,599	1,96
> 150%	319	6,738	7,057	150	2,629	2,779	469	9,367	9,83
Total with LTVs	1,543	8,075	9,618	23,850	8,235	32,085	25,393	16,310	41,70
Minimal security (1)	6	3,144	3,150	54	13	67	60	3,157	3,21
Other (2)	144	1,351	1,495	5,230	933	6,163	5,374	2,284	7,65
Total	1,693	12,570	14,263	29,134	9,181	38,315	30,827	21,751	52,57
Total portfolio average LTV (3)	121%	376%	335%	61%	149%	84%	65%	261%	142%
2012 (4)									
<= 50%	141	18	159	7,210	281	7,491	7,351	299	7,65
> 50% and <= 70%	309	58	367	12,161	996	13,157	12,470	1,054	13,52
> 70% and <= 90%	402	164	566	6,438	1,042	7,480	6,840	1,206	8,04
> 90% and <= 100%	404	137	541	1,542	2,145	3,687	1,946	2,282	4,22
> 100% and <= 110%	111	543	654	1,019	1,449	2,468	1,130	1,992	3,12

> 110% and <= 130%	340	619	959	901	1,069	1,970	1,241	1,688	2,92
> 130% and <= 150%	353	774	1,127	322	913	1,235	675	1,687	2,36
> 150%	1,000	7,350	8,350	595	1,962	2,557	1,595	9,312	10,90
Total with LTVs	3,060	9,663	12,723	30,188	9,857	40,045	33,248	19,520	52,76
Minimal security (1)	8	1,615	1,623	3	13	16	11	1,628	1,63
Other (2)	137	811	948	6,494	1,191	7,685	6,631	2,002	8,63
Total	3,205	12,089	15,294	36,685	11,061	47,746	39,890	23,150	63,04
Total portfolio average LTV (3)	136%	286%	250%	65%	125%	80%	71%	206%	122%

For notes to this table refer to the following page.

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Credit risk continued
Key loan portfolios* continued

	Ulster Bank			Rest of the Group			Group		
Commercial real estate loan-to-value ratio	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
2011									
<= 50%	272	32	304	7,091	332	7,423	7,363	364	7,727
> 50% and <= 70%	479	127	606	14,105	984	15,089	14,584	1,111	15,695
> 70% and <= 90%	808	332	1,140	10,042	1,191	11,233	10,850	1,523	12,373
> 90% and <= 100%	438	201	639	2,616	1,679	4,295	3,054	1,880	4,934
> 100% and <= 110%	474	390	864	1,524	1,928	3,452	1,998	2,318	4,316
> 110% and <= 130%	527	1,101	1,628	698	1,039	1,737	1,225	2,140	3,365
> 130% and <= 150%	506	1,066	1,572	239	912	1,151	745	1,978	2,723
> 150%	912	7,472	8,384	433	2,082	2,515	1,345	9,554	10,899
Total with LTVs	4,416	10,721	15,137	36,748	10,147	46,895	41,164	20,868	62,032
Minimal security (1)	72	1,086	1,158	—	—	—	72	1,086	1,158
Other (2)	193	625	818	8,994	1,844	10,838	9,187	2,469	11,656
Total	4,681	12,432	17,113	45,742	11,991	57,733	50,423	24,423	74,846
Total portfolio average LTV (3)	120%	264%	222%	69%	129%	82%	75%	203%	116%

Notes:

(1) In 2012, the Group reclassified loans with limited (defined as LTV>1,000%) or non-physical security as minimal security, of which a majority were commercial real estate development loans in Ulster Bank. Total portfolio average LTV is quoted net of loans with minimal security given that the anticipated recovery rate is less than 10%. Provisions are marked against these loans where required to reflect the relevant asset quality and recovery profile.

(2) Other non-performing loans of £2.3 billion (2012 - £2.0 billion; 2011 - £2.5 billion) were subject to the Group's standard provisioning policies. Other performing loans of £5.4 billion (2012 - £6.6 billion; 2011 - £9.2 billion) included general corporate loans, typically unsecured, to commercial real estate companies, and major UK house builders in addition to facilities supported by guarantees. The credit quality of these exposures was consistent with that of the performing portfolio overall.

(3) Weighted average by exposure.

(4) 2012 LTV revised to reflect refinement to security value reporting implemented during 2013.

Key points

- The reductions in the higher LTV buckets for the performing book were offset by the growth in these buckets in the non-performing book. Ulster Bank Group accounted for the majority of this deterioration and has addressed this through an increase in provisions (refer to the section on RCR). Ulster Bank Group's provision as a percentage of REIL stood at 76% at 31 December 2013 (2012 - 57%). Valuations continued to be affected by difficult, although improving, market conditions, as well as refinements to the Group's estimation approach.

- Interest payable on outstanding loans was covered 3.1x and 1.6x within UK Corporate and International Banking, respectively, at 31 December 2013 (2012 - 3.0x and 1.5x respectively). The US Retail & Commercial portfolio is managed on the basis of debt service coverage, which includes principal amortisation as well as interest payable. The average debt service coverage was 1.5x at 31 December 2013 (2012 - 1.3x). As a number of different approaches are used across the Group and across geographies to calculate interest coverage ratios, they may not be comparable for different portfolio types and legal entities.

Credit quality metrics relating to commercial real estate lending were as follows:

	Group			Non-Core		
	2013	2012	2011	2013	2012	2011
Lending (gross)	£52.6bn	£63.0bn	£74.8bn	£19.3bn	£26.4bn	£34.3bn
Of which REIL	£20.1bn	£22.1bn	£22.9bn	£14.3bn	£17.1bn	£18.8bn
Provisions	£13.2bn	£10.1bn	£9.5bn	£10.6bn	£8.3bn	£8.2bn
REIL as a % of gross loans to customers	38.2%	35.1%	30.6%	74.1%	64.8%	54.8%
Provisions as a % of REIL	66%	46%	41%	74%	49%	44%

Note:
(1) Excludes property related lending to customers in other sectors managed by Real Estate Finance.

Key point

- CRE lending net of impairment provisions decreased by £13.5 billion or 26% in the year to £39.4 billion in part due to the increased impairment provisions recorded in the fourth quarter of 2013 in Ulster Bank Non-Core, as part of RCR creation and related strategy. Provision coverage on CRE REIL was 66% compared to 46% at the end of 2012.

Ulster Bank is a significant contributor to Non-Core commercial real estate lending. For further information refer to the section on Ulster Bank Group (Core and Non-Core).

*unaudited

Credit risk continued
Key loan portfolios* continued
Residential mortgages
The table below analyses the mortgage portfolios and includes both Core and Non-Core. Total gross mortgage lending comprises 35% of the Group's gross lending of £418 billion.

	2013	2012	2011
	£m	£m	£m
UK Retail	99,338	99,062	96,388
Ulster Bank	19,034	19,162	20,020
RBS Citizens	19,584	21,538	24,153
Wealth	8,701	8,786	8,468
	146,657	148,548	149,029

Refer to pages 257 to 259 for further information on interest only loans.

The table below shows LTVs for the Group's residential mortgage portfolio split between performing (AQ1-AQ9) and non-performing (AQ10), with the average LTV calculated on a weighted value basis. Loan balances are shown as at the end of the year whereas property values are calculated using property index movements since the last formal valuation.

	UK Retail			Ulster Bank			RBS Citizens (1)			W	
	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	pe
Loan-to-value ratio	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
2013											
<= 50%	26,392	313	26,705	2,025	170	2,195	4,669	98	4,767	3,400	
> 50% and <= 70%	34,699	591	35,290	1,837	195	2,032	5,529	89	5,618	3,397	
> 70% and <= 90%	28,920	854	29,774	2,326	288	2,614	5,553	110	5,663	1,337	
> 90% and <= 100%	4,057	315	4,372	1,214	162	1,376	1,309	39	1,348	87	
> 100% and <= 110%	1,790	182	1,972	1,302	182	1,484	752	22	774	87	
> 110% and <= 130%	552	100	652	2,509	461	2,970	637	17	654	27	
> 130% and <= 150%	37	5	42	2,202	549	2,751	183	5	188	4	
> 150%	—	—	—	2,385	1,227	3,612	102	4	106	24	
Total with LTVs	96,447	2,360	98,807	15,800	3,234	19,034	18,734	384	19,118	8,363	
Other (2)	511	20	531	—	—	—	463	3	466	215	
Total	96,958	2,380	99,338	15,800	3,234	19,034	19,197	387	19,584	8,578	
Total portfolio	62%	75%	62%	103%	130%	108%	67%	69%	67%	51%	

average LTV (3)										
Average LTV on new originations during the year (3)			67%			73%			68%	
2012										
<= 50%	22,306	327	22,633	2,182	274	2,456	4,167	51	4,218	3,905
> 50% and <= 70%	27,408	457	27,865	1,635	197	1,832	4,806	76	4,882	2,790
> 70% and <= 90%	34,002	767	34,769	2,019	294	2,313	6,461	114	6,575	1,080
> 90% and <= 100%	7,073	366	7,439	1,119	156	1,275	2,011	57	2,068	93
> 100% and <= 110%	3,301	290	3,591	1,239	174	1,413	1,280	43	1,323	69
> 110% and <= 130%	1,919	239	2,158	2,412	397	2,809	1,263	42	1,305	49
> 130% and <= 150%	83	26	109	2,144	474	2,618	463	14	477	16
> 150%	—	—	—	3,156	1,290	4,446	365	14	379	29
Total with LTVs	96,092	2,472	98,564	15,906	3,256	19,162	20,816	411	21,227	8,031
Other (2)	486	12	498	—	—	—	292	19	311	674
Total	96,578	2,484	99,062	15,906	3,256	19,162	21,108	430	21,538	8,705
Total portfolio average LTV (3)	66%	80%	67%	108%	132%	112%	75%	86%	75%	51%
Average LTV on new originations during the year (3)			65%			74%			64%	

*unaudited

Credit risk continued

Key loan portfolios* continued

	UK Retail			Ulster Bank			RBS Citizens (1)		
	Performing	Non-performing	Total	Performing	Non-performing	Total	Performing	Non-performing	Total
Loan-to-value ratio	£m	£m	£m	£m	£m	£m	£m	£m	£m
2011									
<= 50%	21,537	285	21,822	2,568	222	2,790	4,745	49	4,794
> 50% and <= 70%	25,598	390	25,988	1,877	157	2,034	4,713	78	4,791
> 70% and <= 90%	33,738	671	34,409	2,280	223	2,503	6,893	125	7,018
> 90% and <= 100%	7,365	343	7,708	1,377	128	1,505	2,352	66	2,418
> 100% and <= 110%	3,817	276	4,093	1,462	130	1,592	1,517	53	1,570
> 110% and <= 130%	1,514	199	1,713	2,752	322	3,074	1,536	53	1,589
> 130% and <= 150%	60	15	75	2,607	369	2,976	626	28	654
> 150%	—	—	—	2,798	748	3,546	588	27	615
Total with LTVs	93,629	2,179	95,808	17,721	2,299	20,020	22,970	479	23,449
Other (2)	567	13	580	—	—	—	681	23	704
Total	94,196	2,192	96,388	17,721	2,299	20,020	23,651	502	24,153
Total portfolio average LTV (3)	67%	80%	67%	104%	125%	106%	76%	91%	77%
Average LTV on new originations during the year (3)			63%			74%			63%

Notes:

(1) Includes residential mortgages and home equity loans and lines (refer to page 255 for a breakdown of balances).

(2) Where no indexed LTV is held.

(3) Average LTV weighted by value is calculated using the LTV on each individual mortgage and applying a weighting based on the value of each mortgage.

Key points

UK Retail

- The UK Retail mortgage portfolio was £99.3 billion at 31 December 2013, an increase of 0.3% from 31 December 2012. The mortgages included £9.1 billion (2012 - £7.9 billion) of residential buy-to-let lending.

- As at 31 December 2013, approximately 43% of the portfolio consisted of fixed rate, 5% a combination of fixed and variable rates and the remainder were variable rate mortgages (including those on managed rates). The interest only proportion of the total portfolio was 26%.

- Gross new mortgage lending amounted to £14.4 billion and the average LTV by volume was 62.7% compared to 61.3% at 31 December 2012. The average LTV calculated by weighted LTV of lending was 66.6% (2012 - 65.2%).

- Based on the Halifax Price Index at September 2013, the portfolio-average indexed LTV by volume was 54.1% (2012 - 58.1%) and 62.0% by weighted value of debt outstanding (2012 - 66.8%). The ratio of total outstanding balances to total indexed property valuations was 45.1% (2012 - 48.5%).

- All new mortgage business is subject to a comprehensive assessment. This includes: i) an affordability test which includes a stressed interest rate that is higher than the customer pay rate; ii) credit scoring; iii) a maximum loan-to-value of 90% with the exception of the UK Government backed schemes Help-to-Buy (from the fourth quarter of 2013), New Buy and My New Home products where lending of up to 95% is provided; and iv) a range of policy rules that restrict the availability of credit to borrowers with higher risk characteristics, for example highly indebted and/or adverse payment behaviour on previous borrowings.

- The arrears rate (defined as more than three payments in arrears, excluding repossessions and shortfalls post property sale), fell to 1.3% (2012 - 1.5%). The number of properties repossessed in 2013 was 1,532 compared with 1,426 in 2012. Arrears rates remained sensitive to economic developments and benefited from the low interest rate environment.

- The impairment charge for mortgage loans was £30 million for 2013 compared to £92 million in 2012, reflecting a lower level of defaults and reduced loss rates as valuations improved on properties held as security on defaulted debt.

*unaudited

Credit risk continued
Key loan portfolios* continued
Ulster Bank

- Ulster Bank's residential mortgage portfolio was £19.0 billion at 31 December 2013, with 88% in the Republic of Ireland and 12% in Northern Ireland. The portfolio decreased from 31 December 2012 as a result of amortisation and limited growth due to low market demand.

- The assets included £2.2 billion (12%) of residential buy-to-let loans. The interest rate product mix was approximately 68% on tracker rate products, 23% on variable rate products and 9% on fixed rate. Interest only represented 11% of the total portfolio.

- The average individual LTV on new originations was 73% in 2013, (2012 - 74%); the volume of new business remained very low. The maximum LTV available to Ulster Bank customers was 90% with the exception of a specific Northern Ireland scheme which permits LTVs of up to 95% (although Ulster Bank's exposure is capped at 85% LTV).

- The portfolio average indexed LTV fell 4% during 2013 and reflected positive house price index trends over the last 12 months.

- Refer to the Ulster Bank Group (Core and Non-Core) section on pages 260 to 262 for commentary on mortgage REIL and impairments.

RBS Citizens

- RBS Citizens residential real estate portfolio was £19.6 billion at 31 December 2013 (2012 - £21.5 billion). The Core business comprised 91% of the portfolio. The real estate portfolio consisted of £5.9 billion (£5.6 billion Core vs. £0.3 billion Non-Core) of first lien residential mortgages (1% in second lien position) and £13.5 billion (£12.0 billion Core vs. £1.5 billion Non-Core) of home equity loans and lines (first and second liens). Home equity Core consisted of 49% in first lien position while Non-Core consisted of 95% in second lien position.

- RBS Citizens continued to focus on its 'footprint states' of New England, Mid Atlantic and Mid West regions. At 31 December 2013, the portfolio consisted of £16.4 billion (84% of the total portfolio) within footprint.

- Of the total real estate portfolio of £1.8 billion in Non-Core, the serviced-by-others (SBO) element was the largest component (76%). The SBO book decreased from £1.8 billion at 31 December 2012 to £1.4 billion at 31 December 2013 and was closed to new purchases in the third quarter of 2007. The arrears rate of the SBO portfolio decreased from 1.9% at 31 December 2012 to 1.6% at 31 December 2013 reflecting portfolio liquidation as well as more effective account servicing and collections. The charge-off rate also continued to decrease (4.4% annualised at the fourth quarter of 2013 compared to 7.4% in 2012).

- The weighted average LTV of the portfolio decreased from 75% at 31 December 2012 to 67% at 31 December 2013, driven by increases in the Case-Shiller Home Price Index from the third quarter of 2012 to the fourth quarter of 2013. The weighted average LTV of the portfolio, excluding SBO, was 64%.

*unaudited

Credit risk continued

Key loan portfolios* continued

Personal lending

The Group's personal lending portfolio includes credit cards, unsecured loans, auto finance and overdrafts. The majority of personal lending exposures exist in the UK and the US. Impairment charge as a proportion of average loans and receivables is shown in the following table.

	2013		2012		2011	
	Average loans and receivables	Impairment charge as a % of average loans and receivables	Average loans and receivables	Impairment charge as a % of average loans and receivables	Average loans and receivables	Impairment charge as a % of average loans and receivables
	£m	%	£m	%	£m	%
UK Retail cards (1)	5,626	2.0	5,624	2.3	5,675	3.0
UK Retail loans (1)	5,761	1.6	6,513	2.5	7,755	2.8
RBS Citizens cards (2)	903	3.9	916	3.8	936	5.1
RBS Citizens auto loans (2)	5,080	0.1	5,289	0.1	4,856	0.2

Notes:

(1) The ratio for UK Retail assets refers to the impairment charge for the year.

(2) The ratio for RBS Citizens refers to the impairment charge in the year, net of recoveries realised in the year.

Key points

UK Retail

- The UK personal lending portfolio comprised credit cards, unsecured loans and overdrafts, and totalled £13.8 billion at 31 December 2013 (2012 - £14.7 billion). Loans fell 12%.

- The impairment charge on unsecured lending was £291 million for the year, down 34% on 2012. The decline reflected the effect of prior risk appetite tightening.

- The Group continued to perform favourably relative to industry benchmarks for cards arrears.

RBS Citizens

- RBS Citizens credit card portfolio is comprised of good quality consumer loans originated in-footprint through the RBS Citizen's branch network and totalled £945 million at 31 December 2013 (2012 - £948 million). The product portfolio credit quality continued to improve with credit scores for new originations throughout 2013 higher than the portfolio average.

- Auto loans originated through dealer networks totalled £5.5 billion at 31 December 2013 (2012 - £5.4 billion). The portfolio maintained strong credit fundamentals. New origination credit and collateral characteristics throughout 2013 remained equally strong as a result of the short balance life and the resulting low collateral risk.

*unaudited

Credit risk continued
Key loan portfolios* continued
Interest only retail loans
The Group’s interest only retail loan portfolios include interest only mortgage lending in UK Retail, Ulster Bank and Wealth and RBS Citizens’ portfolios of home equity lines of credit (HELOC) and interest only mortgage portfolios.

	2013		2012	
	Mortgages	Other loans	Mortgages	Other loans (1)
	£bn	£bn	£bn	£bn
Variable rate	34.8	1.3	38.5	1.5
Fixed rate	8.0	0.1	8.1	0.1
Interest only loans	42.8	1.4	46.6	1.6
Mixed repayment (2)	8.3	—	8.8	—
Total	51.1	1.4	55.4	1.6

Notes:
(1) The other loans category for 2012 has been restated to exclude non-personal interest only loans within Wealth division.
(2) Mortgages with partial interest only and partial capital repayments.

The Group reduced its exposure to interest only mortgages. UK Retail ceased offering interest only mortgages to residential owner occupied customers with effect from 1 December 2012. Interest only repayment remains an option for buy-to-let mortgages. Ulster Bank withdrew interest only as a standard mortgage offering for new lending in the Republic of Ireland in 2010 and in Northern Ireland in 2012. Interest only mortgages are now granted on a very limited basis to high net worth customers or as part of its forbearance programme. RBS Citizens offers its customers interest only mortgages and conventional HELOC that enter an amortising repayment period after the interest only period. Wealth offers interest only mortgages to its high net worth customers.

The Group recognises impairment provisions in respect of loans in its interest only portfolios (UK Retail - 2 years; RBS Citizens - 1 year) that are approaching their contractual maturity based on historical analysis and customer behaviour. These impairment provisions are refreshed as new trends and data become available.

The tables below analyse the Group’s interest only mortgage and HELOC portfolios (excluding mixed repayment mortgages) by type, by contractual year of maturity and by originating division.

	2014 (1)	2015-16	2017-21	2022-26	2027-31	2032-41	After 2041	Total
2013	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Bullet principal repayment (2)	0.9	2.1	6.0	7.6	7.9	7.5	0.5	32.5
Conversion to amortising (2,3)	1.9	6.0	2.2	0.1	—	0.1	—	10.3
Total	2.8	8.1	8.2	7.7	7.9	7.6	0.5	42.8

	2013 (4)	2014-15	2016-20	2021-25	2026-30	2031-40	After 2040	Total
2012	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Bullet principal repayment (2)	1.4	2.9	6.8	5.9	8.1	9.9	0.7	35.7

Conversion to amortising (2,3)	0.5	1.7	5.8	2.7	0.1	0.1	—	10.9
Total	1.9	4.6	12.6	8.6	8.2	10.0	0.7	46.6

Notes:
(1) 2014 includes pre-2014 maturity exposure.
(2) Includes £2.3 billion (2012 - £2.2 billion) of repayment mortgages that have been granted interest only concessions (forbearance).
(3) Maturity date relates to the expiry of the interest only period.
(4) 2013 includes pre-2013 maturity exposure.

*unaudited

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Business review Risk and balance sheet management

Credit risk continued
Key loan portfolios* continued

	2013				2012			
	Bullet principal repayment £bn	Conversion to amortising £bn	Total £bn	Proportion of mortgage lending %	Bullet principal repayment £bn	Conversion to amortising £bn	Total £bn	Proportion of mortgage lending %
UK Retail (1)	25.4	—	25.4	25.6	28.1	—	28.1	28.4
Ulster Bank	0.7	1.4	2.1	11.0	1.4	1.8	3.2	16.7
RBS Citizens	0.4	8.9	9.3	47.5	0.5	9.0	9.5	44.1
Wealth	6.0	—	6.0	69.0	5.7	0.1	5.8	66.0
Total	32.5	10.3	42.8		35.7	10.9	46.6	

Note:
(1) UK Retail also has exposure of £7.7 billion to customers who have a combination of repayment types, capital repayments and interest only.

UK Retail
UK Retail's interest only mortgages require full principal repayment (bullet) at the time of maturity. Typically such loans have remaining terms of between 15 and 20 years. Customers are reminded of the need to have an adequate repayment vehicle in place during the mortgage term.

Of the bullet loans that matured in the six months to 30 June 2013, 53% had been fully repaid by 31 December 2013. The unpaid balance totalled £51 million, 96% of which continued to meet agreed payment arrangements (including balances that have been restructured on a capital and interest basis within eight months of the contract date; customers are allowed eight months leeway for their investment plan to mature and cashed in to repay the mortgage). Of the £51 million unpaid balance, 56% of the loans had an indexed LTV of 70% or less with only 14% above 90%. Customers may be offered a short extension to the term of an interest only mortgage or a conversion of an interest only mortgage to one featuring repayment of both capital and interest, subject to affordability and characteristics such as the customer's income and ultimate repayment vehicle. The majority of term extensions in UK Retail are classified as forbearance.

Ulster Bank
Ulster Bank's interest only mortgages require full principal repayment (bullet) at the time of maturity; or payment of both capital and interest from the end of the interest only period, typically seven years, so that customers meet their contractual repayment obligations. For bullet customers, contact strategies are in place to remind them of the need to repay principal at the end of the mortgage term.

Of the bullet mortgages that matured in the six months to 30 June 2013 (£1.2 million), 20% had fully repaid by 31 December 2013 leaving residual balances of £0.9 million, 78% of which were meeting the terms of a revised repayment schedule. Of the amortising loans that matured in the six months to 30 June 2013 (£65 million), 69% were either fully repaid or meeting the terms of a revised repayment schedule.

Ulster Bank also offers temporary interest only periods to customers as part of its forbearance programme. An interest only period of up to two years is permitted after which the customer enters an amortising repayment period following further assessment of the customer's circumstances. The affordability assessment conducted at the end of the forbearance period takes into consideration the repayment of the arrears that have accumulated based on original terms during the forbearance period. The customer's delinquency status does not deteriorate further while forbearance repayments are maintained. Term extensions in respect of existing interest only mortgages are offered only under a forbearance arrangement.

RBS Citizens

RBS Citizens has a book of interest only bullet repayment HELOC loans (£0.4 billion at 31 December 2013) for which repayment of principal is due at maturity, and an interest only portfolio that comprises loans that convert to amortising after an interest only period that is typically 10 years (£8.9 billion at December 2013 of which £8.0 billion are HELOCs). The majority of the bullet loans are due to mature between 2014 and 2015. Of the bullet loans that matured in the six months to 30 June 2013, 50% had fully repaid or are current as of 31 December 2013. The residual balances (modified, delinquent, and charged-off) made up £21 million. For those loans that convert to amortising, the typical uplift in payments is currently 210% (average uplift calculated at £132 per month). Delinquency rates have shown a modest increase in the over 30 days arrears rate.

*unaudited

Credit risk continued

Key loan portfolios* continued

The tables below analyse the Group's retail mortgage and HELOC portfolios between interest only mortgages (excluding mixed repayment mortgages) and other mortgage loans.

	Interest only			
	Bullet principal repayment	Conversion to amortising	Other	Total
2013	£bn	£bn	£bn	£bn
Arrears status				
Current	31.2	9.6	97.0	137.8
1 to 90 days in arrears	0.7	0.4	2.8	3.9
90+ days in arrears	0.6	0.3	4.1	5.0
Total	32.5	10.3	103.9	146.7
2012				
Arrears status				
Current	34.4	10.0	94.4	138.8
1 to 90 days in arrears	0.6	0.4	3.3	4.3
90+ days in arrears	0.7	0.5	4.2	5.4
Total	35.7	10.9	101.9	148.5

	Interest only	Other	Total
2013	£bn	£bn	£bn
Current LTV			
<= 50%	10.8	26.3	37.1
> 50% and <= 70%	14.6	31.8	46.4
> 70% and <= 90%	10.8	28.6	39.4
> 90% and <= 100%	2.6	4.6	7.2
> 100% and <= 110%	1.5	2.8	4.3
> 110% and <= 130%	0.9	3.4	4.3
> 130% and <= 150%	0.5	2.5	3.0
> 150%	0.7	3.1	3.8
Total with LTVs	42.4	103.1	145.5
Other	0.4	0.8	1.2
Total	42.8	103.9	146.7
2012			
Current LTV			
<= 50%	10.3	22.9	33.2
> 50% and <= 70%	12.4	25.0	37.4
> 70% and <= 90%	13.6	31.2	44.8
> 90% and <= 100%	3.6	7.3	10.9
> 100% and <= 110%	2.4	4.0	6.4
> 110% and <= 130%	2.0	4.3	6.3
> 130% and <= 150%	0.8	2.4	3.2
> 150%	1.2	3.7	4.9

Total with LTVs	46.3	100.8	147.1
Other	0.3	1.1	1.4
Total	46.6	101.9	148.5

*unaudited

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Credit risk continued
Key loan portfolios* continued
Ulster Bank Group (Core and Non-Core)
Overview
At 31 December 2013, Ulster Bank Group accounted for 10% of the Group's total gross loans to customers (2012 and 2011 - 10%) and 8% of the Group's Core gross loans to customers (2012 and 2011 - 8%) Ulster Bank's financial performance continued to be impacted by the challenging economic climate in Ireland, with impairments remaining elevated in the wholesale bank as a result of limited liquidity in the economy which continues to depress the property market and domestic spending. Additionally, in the fourth quarter of 2013 the Group announced a recovery strategy for loans transferring to RCR. This resulted in a significant increase in provisions as the move from a through the cycle strategy to a 3 year deleverage, reduced expected realisations.

The impairment charge of £4,793 million for 2013 (2012 - £2,340 million; 2011 - £3,717 million) was driven by a combination of new defaulting customers and higher provisions on existing defaulted cases due primarily to the above mentioned RCR strategy. Provisions as a percentage of risk elements in lending increased to 76% in 2013, from 57% in 2012, predominantly as a result of this change in strategy, combined with the deterioration in the value of the Non-Core commercial real estate development portfolio.

Core
The impairment charge for the year of £1,774 million (2012 - £1,364 million; 2011 - £1,384 million) reflected the difficult economic climate in Ireland, and most particularly the RCR deleverage strategy across the corporate portfolios. The mortgage portfolio improved notably in 2013, accounting for £235 million (13%) of the total 2013 impairment charge (2012 - £646 million; 2011 - £570 million) due to lower debt flows driven by improved collections performance and stabilising residential property prices.

Non-Core
The impairment charge for the year was £3,019 million (2012 - £976 million; 2011 - £2,333 million), with the commercial real estate sector accounting for £2,674 million (89%) of the total 2013 impairment charge, again reflecting the RCR strategy.

The table below analyses Ulster Bank Group's loans, REIL, impairments and related credit metrics by sector.

				Credit metrics				
				REIL as a % of gross loans	Provisions as a % of REIL	Provisions as a % of gross loans	Impairment charge (1)	Amounts written-off
	Gross loans	REIL	Provisions					
Sector analysis	£m	£m	£m	%	%	%	£m	£m
2013								
Core								
Mortgages	19,034	3,235	1,725	17.0	53	9.1	235	34
Commercial real estate								
- investment	3,419	2,288	1,151	66.9	50	33.7	593	51
- development	718	472	331	65.7	70	46.1	153	4
Other corporate	7,039	2,277	1,984	32.3	87	28.2	771	149
Other lending	1,236	194	187	15.7	96	15.1	22	39

	31,446	8,466	5,378	26.9	64	17.1	1,774	277
Non-Core								
Commercial real estate								
- investment	3,211	3,006	2,162	93.6	72	67.3	837	53
- development	6,915	6,757	6,158	97.7	91	89.1	1,837	370
Other corporate	1,479	1,209	1,069	81.7	88	72.3	345	6
	11,605	10,972	9,389	94.5	86	80.9	3,019	429
Ulster Bank Group								
Mortgages	19,034	3,235	1,725	17.0	53	9.1	235	34
Commercial real estate								
- investment	6,630	5,294	3,313	79.8	63	50.0	1,430	104
- development	7,633	7,229	6,489	94.7	90	85.0	1,990	374
Other corporate	8,518	3,486	3,053	40.9	88	35.8	1,116	155
Other lending	1,236	194	187	15.7	96	15.1	22	39
	43,051	19,438	14,767	45.2	76	34.3	4,793	706

Note:

(1) Of which £3.2 billion was due to RCR and the related change of strategy.

*unaudited

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Credit risk continued
Key loan portfolios* continued

				Credit metrics				
				REIL as a %	Provisions	Provisions		
	Gross			of	as a % of	as a % of	Impairment	Amounts
				gross		gross		
	loans	REIL	Provisions	loans	REIL	loans	charge	written-off
Sector analysis	£m	£m	£m	%	%	%	£m	£m
2012								
Core								
Mortgages	19,162	3,147	1,525	16.4	48	8.0	646	22
Commercial real estate								
- investment	3,575	1,551	593	43.4	38	16.6	221	—
- development	729	369	197	50.6	53	27.0	55	2
Other corporate	7,772	2,259	1,394	29.1	62	17.9	389	15
Other lending	1,414	207	201	14.6	97	14.2	53	33
	32,652	7,533	3,910	23.1	52	12.0	1,364	72
Non-Core								
Commercial real estate								
- investment	3,383	2,800	1,433	82.8	51	42.4	288	15
- development	7,607	7,286	4,720	95.8	65	62.0	611	103
Other corporate	1,570	1,230	711	78.3	58	45.3	77	23
	12,560	11,316	6,864	90.1	61	54.6	976	141
Ulster Bank Group								
Mortgages	19,162	3,147	1,525	16.4	48	8.0	646	22
Commercial real estate								
- investment	6,958	4,351	2,026	62.5	47	29.1	509	15
- development	8,336	7,655	4,917	91.8	64	59.0	666	105
Other corporate	9,342	3,489	2,105	37.3	60	22.5	466	38
Other lending	1,414	207	201	14.6	97	14.2	53	33
	45,212	18,849	10,774	41.7	57	23.8	2,340	213
2011								
Core								
Mortgages	20,020	2,184	945					